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Robbing Peter To Pay Paul: Charitable Donations as Fraudulent Transfers

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COMMENTS

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"The delightful quality of fraud lies in its infinite variety . . . ."[1]

I. Introduction

When Bruce and Nancy Young's electrical contracting business began losing money, the couple decided that their financial troubles would not prevent them from continuing to give ten percent of their income to their church, as they had for years.[2] Even when forced to sell their home and household goods, the Youngs continued to tithe.[3] When the couple finally filed a chapter 7 bankruptcy petition, their financial records revealed that they had given $13,450 worth of monthly donations to the church in the year prior to filing.[4] The trustee appointed in their case asked the bankruptcy court to order the church to turn over the Young's tithes as fraudulent transfers, and the court agreed.[5]

Despite the pejorative sound of their title, fraudulent transfers need not be fraudulent. While transfers made with the intent to defraud creditors may be voided,[6] almost all fraudulent conveyance statutes also permit creditors to pursue transfers made with perfectly innocent motives, if made by an insolvent debtor for less than adequate consideration.[7] The concern is that if a debtor, while insolvent, transfers away her property and receives nothing in return, her creditors may be left without adequate assets to pursue to satisfy their claims; fraudulent conveyances are voidable by creditors, or by a bankruptcy trustee, when they unfairly prejudice the creditors' position.[8]

This objective approach to fraudulent conveyance law has avoided the evidentiary problems of proving actual intent to defraud, and has placed an emphasis instead on the impact of a

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1. GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES 566 (1940).

2. Pierre Thomas, *Clinton Stops Justice Department from Seeking Forfeiture of Tithes*, WASH. POST, Sept. 16, 1994, at a8; Laurie Goodstein, *Religious Groups Fight U.S. in Bankruptcy Case*, WASH. POST, May 23, 1994, at a1.

3. Goodstein, *supra* note 2, at a1.

4. *In re* Young (Christians v. Crystal Evangelical Free Church), 152 B.R. 939, 943 (D. Minn. 1993).

5. *Id.* The *Young* decision was on appeal to the Eighth Circuit Court of Appeals when this Comment went to press. Thomas, *supra* note 2, at a8.

6. 11 U.S.C. § 548(a)(1) (1993); U.F.T.A. § 4(a)(1) (1984); U.F.C.A. § 7 (1918).

7. 11 U.S.C. § 548(a)(2); U.F.T.A. § 5; U.F.C.A. § 4.

8. *See* U.F.T.A. § 3 cmt. 2, 7A U.L.A. 651 (1985) ("Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition [of the required value given in exchange for the transfer in question].").

transaction from the creditor's point of view.[9] While objectivity simplifies the analysis of an allegedly fraudulent exchange of property for property, it creates problems in approaching transfers that do not have a direct impact on creditors. Many commercial transactions, such as the purchase of entertainment, will be for fair consideration from the point of view of the transferee, but not from the point of view of creditors. It seems unjust to ask the transferee to disgorge the funds transferred, when it engaged in an ordinary market exchange.

The issues surrounding charitable contributions are both clearer and more difficult. A donation, by its very nature, is not an exchange for value.[10] Voluntary conveyances (those made without consideration) by insolvents strike at the very heart of the policy underlying the law of fraudulent transfers: an insolvent must be just before she is generous.[11]

When the debtor has an ongoing relationship with the charity, the transaction can be complex, with benefits of some sort flowing both ways.[12] Moreover, many charities perform valuable social functions. Churches, museums, volunteer fire companies, institutions of higher learning, historical societies, and many other charitable and not-for-profit organizations contribute to the public welfare. Treating donations to such institutions as fraudulent conveyances could represent a significant financial burden to them; the voiding of charitable contributions as constructively fraudulent

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9. *See infra* note 63 and accompanying text.

10. United States v. American Bar Endowment, 477 U.S. 105, 117 (1986).

11. This equitable maxim is widely cited by courts in the context of fraudulent conveyances. *E.g.*, Rudy v. Austin, 19 S.W. 111, 113 (Ark. 1892); Mercantile Nat'l Bank v. Aldridge, 210 S.E.2d 791, 793 (Ga. 1974); Birney v. Solomon, 181 N.E. 318, 320 (Ill. 1932); First Nat'l Bank in Fairfield v. Frescoln Farms, Ltd., 430 N.W.2d 432, 436 (Iowa 1988); Lutherville Supply & Equip. Co. v. Dimon, 192 A.2d 496, 498 (Md. 1963); Boston Trading Group v. Burnazos, 835 F.2d 1504, 1508 (1st Cir. 1987) (interpreting Massachusetts law); Lafayette Fin. Corp. v. Cunningham, 143 A.2d 700, 702 (R.I. 1958); Durham v. Blackard, 438 S.E.2d 259, 263 (S.C. Ct. App. 1993); Walker v. Loring, 36 S.W. 246, 247 (Tex. 1896); Brimhall v. Grow, 480 P.2d 731, 734 (Utah 1971).

This principle is also cited by courts requiring that the debts of a decedent's estate must be paid before the gifts in her will can be effectuated. *E.g.*, First Security Trust Co. v. Lentz, 145 S.E. 776, 779 (N.C. 1928) ("[The debtor] has nothing to give away until his debts have been paid or his obligations have been fulfilled. Equity, which delighteth in equality, as well as the law, which commands the right, requires that a man shall be just before he is generous, for generosity ceases to be a virtue when indulged in at the expense of creditors."); *In re* Breault's Estate (Soble v. Breault), 211 N.E.2d 424, 434 (Ill. App. Ct. 1965); *In re* Kovalyshyn's Estate, 343 A.2d 852, 859 (N.J., Hudson County Probate Ct., 1976).

12. *See infra* text accompanying notes 140-66.

raises significant public policy questions. Underlying all of these issues is the question of who should bear the burden of a debtor's pre-bankruptcy fiscal decisions.

This Comment seeks to develop a consistent analytical framework for the examination of these issues through an extension of the Supreme Court's recent decision in *BFP v. Resolution Trust Corp.*[13] The *BFP* decision arguably modifies fraudulent conveyance jurisprudence by suggesting that, as a matter of law, a commercially reasonable, arm's length transaction is not a fraudulent transfer. Part II considers whether charitable contributions made by insolvent debtors are fraudulent conveyances under the law as is now stands. This section examines the current state of fraudulent conveyance doctrine, in light of its historical development, and considers the implications of the *BFP* decision to fraudulent conveyance law in general, and to the law as it applies to voluntary transfers in particular. Part III examines the question of whether charitable contributions by insolvents should be treated as fraudulent as a matter of policy, and discusses possible alternative responses to inappropriate expenditures by insolvents. Part IV concludes that the principle of shared sacrifice, essential to bankruptcy policy, requires some limitations on a debtor's charitable giving.

For the transactions discussed in this Comment, it is presumed that the debtor was insolvent at the time the transfer was made. In many of the situations discussed, insolvency would, in fact, have to be established as an element of the action for the transfer in question to be deemed constructively fraudulent.[14] Unless otherwise indicated, all transactions are also presumed to have been made in good faith, with no actual intent to defraud.

II. Are Charitable Contributions by Insolvent Debtors Fraudulent Conveyances?

A. History and Development of Fraudulent Conveyance Law

1. The Statute of Elizabeth. — Fraudulent conveyance law has its origins in Roman bankruptcy law: any transfer made by the debtor in the "suspicious period" of the 30 days prior to bankrupt-

13. 114 S. Ct. 1757 (1994).
14. 11 U.S.C. § 548(a)(2)(B)(i); U.F.T.A. §§ 4(a)(2), 5(a); U.F.C.A. § 4.

cy was presumed fraudulent.[15] The modern laws are derived from England's Statute of Elizabeth,[16] passed in 1571. Sixteenth-century English law was riddled with loopholes allowing debtors to frustrate their creditors. It was easy for a debtor to transfer all of his possessions to a friend or relative and seek sanctuary from the King's writ in certain protected areas.[17] From this position of safety, debtors could easily force frustrated creditors to compromise their claims.[18]

The Statute of Elizabeth codified a number of revisions to sanctuary laws, permitting creditors to pursue a debtor's property despite a supposed transfer.[19] The Statute was designed specifically to deal with the problem of transfers made with "intent to delaye hinder or defraude creditors . . . ."[20] It is noteworthy that the Statute was not actually designed with protection of creditors as its foremost concern; a revenue-raising measure, it provided that one-half of the property fraudulently conveyed would be forfeited to the crown, while the other half would go to the creditors.[21] The Statute did not actually give creditors a direct remedy against a debtor's conveyances, being structured instead as a penal measure.[22] The same year that the Statute was passed, however, an English court, citing the new statute against fraudulent conveyances, permitted a creditor to bring an action directly to disregard a transfer made with intent to defraud.[23]

The best-known case interpreting the Statute of Elizabeth is *Twyne's Case*,[24] which concerned a transfer designed to frustrate a creditor's attempt to levy on the debtor's sheep.[25] The *Twyne* court found that the transfer of the sheep was made with intent to defraud creditors, based on certain "signs and marks of fraud,"[26] such as that the gift was general (transferring all of the debtor's

15. GLENN, *supra* note 1, at 82-83; *see also* Max Radin, *Fraudulent Conveyances at Roman Law*, 18 VA. L. REV. 109 (1931).

16. 13 Eliz., ch. 5 (Eng. 1571).

17. Available sanctuary included certain precincts protected by statute, royal grant, or church sanction. GLENN, *supra* note 1, at 84.

18. *Id.*

19. *Id.* at 85.

20. 13 Eliz., ch. 5.

21. *Id.*; GLENN, *supra* note 1, at 89.

22. 13 Eliz., ch. 5.

23. Mannockes' Case, 3 Dyer 294b, 73 Eng. Rep. 661 (K.B. 1571).

24. 3 Co. Rep. 80b, 76 Eng. Rep. 809 (Star Chamber 1601).

25. *Id.* at 80b, 76 Eng. Rep. at 811.

26. *Id.* at 80b, 76 Eng. Rep. at 812.

assets), the debtor retained possession after the gift was made, the gift was made in secret, and it was made pending the creditor's action.[27] Basing its decision on objective factors allowed the *Twyne* court to avoid the troublesome evidentiary problem of determining the debtor's intentions. This approach, applying "badges of fraud" to determine whether a transfer was made with fraudulent intent, continues to this day, having been codified in the Uniform Fraudulent Transfer Act.[28]

The objectification of fraudulent conveyance law was continued by the English Bankruptcy Act of 1603,[29] which made fraudulently conveyed property part of the bankruptcy estate.[30] significantly, this amendment included in its definition of fraudulent all conveyances made without "valuable consideration."[31] Voiding transfers that are constructively fraudulent eliminated the problem of interpreting debtors' motivations. It also shifted the focus from debtors' malfeasance to the impact of their actions upon their creditors. *Colville v. Parker*,[32] a 1608 case under a revised version of the fraudulent conveyance statute,[33] cites an unreported decision in *Woodie's Case* for the proposition that a voluntary conveyance creates a presumption of fraudulent intent.[34] By the eighteenth century, the idea that voluntary transfers were voidable as constructively fraudulent was firmly a part of fraudulent conveyance law.[35]

Constructive fraud has become a fundamental part of modern fraudulent conveyance doctrine; the voiding of conveyances made by insolvents without consideration is based not upon a desire to

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27. *Id.* at 80b-81a, 76 Eng. Rep. at 812-13.

28. U.F.T.A. § 4(b) (1984).

29. 1 James 1, ch. 13 (1603).

30. *Id.*

31. *Id.* Debtors should note that further revisions to the English Bankruptcy Act in 1623 made the punishment for intentionally fraudulent conveyances pillory and loss of an ear. GLENN, *supra* note 1, at 98.

32. Cro. Jac. 158, 79 Eng. Rep. 138 (K.B. 1608).

33. 27 Eliz., ch. 4 (1585).

34. *Colville*, Cro. Jac. at 158, 79 Eng. Rep. at 138.

35. *E.g.*, Fitzer v. Fitzer, 2 Atk. 511, 26 Eng. Rep. 708 (Ch. 1742) (voluntary conveyance from husband to wife, with love and affection as the only consideration, is fraudulent); Stileman v. Ashdown, 2 Atk. 477, 26 Eng. Rep. 9 (Ch. 1738) (question of fraud determined by looking at transaction from creditor's viewpoint); *see also* Doe v. Manning, 9 East 59, 103 Eng. Rep. 495 (K.B. 1807) (fraud inferred in law for voluntary conveyance, despite absence of fraud in fact); Lord Townshend v. Windham, 2 Ves. Sen. 1, 28 Eng. Rep. 1 (Ch. 1750) (voluntary conveyance fraudulent per se).

punish the parties to the transaction for some wrongdoing, but upon the equitable principle that an insolvent must be just before she is generous.[36]

2. The Uniform Fraudulent Conveyance Act. — The statute of Elizabeth formed the basis of American fraudulent conveyance law, having been codified by statute in many states, and as a part of the common law in others.[37] In 1918, however, the Uniform Fraudulent Conveyance Act was promulgated to modernize and unify the various state statutes.[38] In addition to invalidating as to creditors all conveyances made with an intent to defraud,[39] the U.F.C.A. also treats as fraudulent those conveyances made by insolvents for less than fair consideration.[40] The uniform act thereby places constructive fraud on the same level as intentional fraud. In many constructive fraud cases, the outcome turns on the question of "fair consideration," which is defined as a fair equivalent given in good faith.[41] By including a good faith requirement, the U.F.C.A. directs its attention to the nature of the exchange attacked. Even when a conveyance is challenged without regard to actual intent to defraud, a court must consider the good faith of the transferee.

3. Section 548 of the Bankruptcy Code. — At its height, the U.F.C.A. was the law in only twenty-six states.[42] It nonetheless had an impact on the drafting of the fraudulent conveyance statute contained within the Bankruptcy Act of 1938,[43] which followed its approach.[44] The Bankruptcy Reform Act of 1978,[45] however, changed the law of bankrupts' fraudulent conveyances. Section 548 of the Bankruptcy Code changed the U.F.C.A.'s "fair consideration" approach to one which looks for "reasonably equivalent

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36. *See supra* note 11.

37. GLENN, *supra* note 1, at 79-80.

38. Prefatory note to U.F.C.A., 7A U.L.A. 427-28 (1985).

39. U.F.C.A. § 7 (1918).

40. *Id.* § 4 ("Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.").

41. *Id.* § 3(a).

42. PETER A. ALCES, THE LAW OF FRAUDULENT TRANSACTIONS 5-13 (1989).

43. (Chandler Act), ch. 575, 52 Stat. 840 (superseded by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C.)).

44. GLENN, *supra* note 1, at 101.

45. Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C.).

value."[46] The primary effect of this change was to dispense with the U.F.C.A.'s good faith inquiry, completing the objectification of fraudulent conveyance law. The focus had turned completely to the impact that the transaction has on creditors.

Section 548 provides that a trustee may avoid any transfer made by an insolvent debtor in the year prior to bankruptcy, if the debtor "received less than a reasonably equivalent value in exchange . . . ."[47] As under the U.F.C.A., the value analysis tends to focus on the economic character of the transaction. Good faith has been removed from the calculation (except when the debtor has actual intent to defraud),[48] other than as a defense that may be raised by the transferee to protect its interest in the transaction.[49]

4. The Uniform Fraudulent Transfer Act. — The Uniform Fraudulent Transfer Act was introduced in the 1980s to harmonize

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46. 11 U.S.C. § 548(a)(2)(A).

47. *Id.* § 548(a)(2). The key provision of Section 548 reads as follows:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> (1) made such transfer or incurred such obligation with *actual intent* to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (2)(A) received *less than a reasonably equivalent value* in exchange for such transfer or obligation; and
>
> (B) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation . . . .

Id. (emphasis added).

The Supreme Court has suggested that "'reasonably equivalent' means 'approximately equivalent,' or 'roughly equivalent.'" BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1762 n.4 (1994). The Court limited its decision in *BFP* to cases concerning mortgage foreclosures of real estate. *Id.* at 1761 n.3. This general, common-sense definition of value does not, however, seem inherently dependent on the factual context.

Section 548 defines "value" as: "property, or satisfaction or securing of a present or antecedent debt of the debtor . . . ." 11 U.S.C. § 548(d)(2)(A). However, value "does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor . . . ." *Id.*

48. *Id.* § 548 (a)(1).

49. "[A] transferee or obligee of such a transfer or obligation that takes *for value and in good faith* has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation." *Id.* § 548(c) (emphasis added).

state law with the Bankruptcy Code and to clarify the emphasis on economic value.[50] The U.F.T.A.'s constructive fraud language is similar to that of Section 548, voiding transfers made by insolvents without "reasonably equivalent value."[51] The inquiry into what the debtor received in exchange for the allegedly fraudulent transfer is thus essentially the same under both the Bankruptcy Code and the U.F.T.A.: Did the debtor receive "reasonably equivalent value"? The comments to the U.F.T.A. establish that the value in question must be commercial in nature: "Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition."[52]

The inquiry is thus shifted completely from the debtor's thoughts at the time of the transfer to the impact of the transfer upon the creditors. The evidentiary issue of intent may be completely avoided when the debtor gave more than she got. This transition emphasizes a shift in the policy underlying fraudulent conveyance law. The Statute of Elizabeth was a penal measure, which punished wrongful behavior. The modern fraudulent conveyance statutes are concerned not so much with morality as with a maximization of assets available for creditors.

B. The Current State of the Law

The U.F.T.A. is presently the law in thirty-two states.[53]

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50. Prefatory note to U.F.T.A., 7A U.L.A. 639-40 (1985).

51. U.F.T.A. § 5(a). The constructive fraud provision reads:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a *reasonably equivalent value* in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

Id. (emphasis added). The U.F.T.A.'s definition of value is: "Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person." *Id.* § 3(a).

52. *Id.* § 3 cmt. 2, 7A U.L.A. 651 (1985).

53. ALA. CODE § 8-9a (1975); ARIZ. REV. STAT. ANN. §§ 44-1001 to -1010 (1994); ARK. CODE ANN. §§ 4-59-201 to -213 (Michie 1991); CAL. CIV. CODE § 3439 (West 1984); COLO. REV. STAT. § 38-8 (Supp. 1994); CONN. GEN. STAT. §§ 52-552a to -5521 (Supp. 1994); FLA. STAT. ANN. §§ 726.101 to 726.112 (West 1988); HAW. REV. STAT. §§ 651c-1 to -10 (1985); IDAHO CODE §§ 55-910 to -921 (1994); ILL. REV. STAT. ch. 740, para. 160/1 to 160/12 (1992); IND. CODE §§ 32-2-7-1 to -21 (Supp. 1994); ME. REV. STAT. ANN. tit. 14, §§ 3571 to 3582 (West Supp. 1993); MINN. STAT. §§ 513.41 to 513.51 (1990); MO. REV. STAT. §§ 428.005 to

Another seven states continue to follow the U.F.C.A.[54] The remaining eleven states all have fraudulent conveyance statutes of some sort; while their statutory language varies, most follow the modern, creditor's-point-of-view approach.[55] A few others employ a more traditional Statute of Elizabeth method, using badges of fraud to infer fraudulent intent.[56]

A bankruptcy trustee who believes that the debtor made a fraudulent conveyance may proceed against the transferee under

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828.059 (Supp. 1994); MONT. CODE ANN. §§ 31-2-326 to -342 (1993); NEB. REV. STAT. §§ 36-701 to -712 (Supp. 1992); NEV. REV. STAT. §§ 112.140 to 112.250 (1993); N.H. REV. STAT. ANN. §§ 545-A:1 to A:12 (1993); N.J. STAT. §§ 25:2-20 to -34 (Supp. 1994); N.M. STAT. ANN. §§ 56-10-14 to -25 (Michie Supp. 1994); N.D. CENT. CODE §§ 13-02.1-01 to -10 (1991); OHIO REV. CODE ANN. §§ 1336.01 to 1336.11 (Baldwin 1988); OKLA. STAT. tit. 24, §§ 112 to 123 (1987); OR. REV. STAT. §§ 95.200 to 95.310 (1993); 12 PA. CONS. STAT. §§ 5101 to 5110 (Supp. 1994); R.I. GEN. LAWS §§ 6-16-1 to -12 (1992); S.D. CODIFIED LAWS ANN. §§ 54-8A-1 to -12 (Supp. 1994.); TEX. BUS. & COM. CODE ANN. §§ 24.001 to 24.012 (West 1987); UTAH CODE ANN. §§ 25-6-1 to -13 (Supp. 1994); WASH. REV. CODE §§ 19.40.011 to 19.40.903 (1989); W. VA. CODE §§ 10-1A-1 to -12 (Supp. 1994); WIS. STAT. §§ 242.01 to 242.11 (Supp. 1994).

54. DEL. CODE ANN. tit. 6, §§ 1301 to 1312 (1993); MD. CODE ANN. COM. LAW I §§ 15-201 to -214 (1990); MASS. GEN. L. ch. 109A (1990); MICH. COMP. LAWS §§ 26.881 to 26.893 (1992); N.Y. DEBT. & CRED. LAW §§ 270 to 281 (McKinney 1990); TENN. CODE ANN. §§ 66-3-301 to -314 (1993); WYO. STAT. §§ 34-14-101 to -113 (1993).

55. GA. CODE ANN. § 18-2-21 (1990) ("Creditors may attack as fraudulent a judgment, conveyance, or any other arrangement interfering with their rights, either at law or in equity."); *id.* § 18-2-22 (conveyances made with intent to defraud creditors or without valuable consideration void); IOWA CODE § 639.3 (1950) (permitting attachment of property where debtor is about to dispose of it fraudulently); Graham v. Henry, 456 N.W.2d 364 (Iowa 1990) (transfer made with fraudulent intent may be set aside); First Nat'l Bank in Fairfield v. Frescoln Farms, Ltd., 430 N.W.2d 432 (Iowa 1988) (transfer without consideration fraudulent regardless of intent); KY. REV. STAT. ANN. § 378.020 (Baldwin 1993) (voiding transfers made without valuable consideration); LA. CIV. CODE ANN. art. 2036 (West 1987) ("An obligee has a right to annual an act of the obligor . . . that causes or increases the obligor's insolvency."); MISS. CODE ANN. § 15-3-3 (Supp. 1993) (unrecorded conveyances made without "consideration deemed valuable in law" fraudulent); N.C. GEN. STAT. § 39-15 (1984) (reenactment of Statute of Elizabeth, regarding intent to defraud); *id.* § 39-17 (voluntary gift not fraud per se, but insolvency may be taken as evidence of intent to defraud); Everett v. Gainer, 153 S.E.2d 90 (N.C. 1967) (voluntary gift fraudulent regardless of intent); S.C. CODE ANN. § 27-23-10 (Law. Co-op. 1976) (Statute of Elizabeth, regarding intentional fraud); Farmers' Bank v. Bradham, 123 S.E. 835 (S.C. 1924) (transfer without consideration fraudulent regardless of intent); VA. CODE ANN. § 55-80 (1986) (intent to defraud); *id.* § 55-81 (gifts "not upon consideration deemed valuable in law" void).

56. ALASKA STAT. § 34.40 (1990) (intent to defraud); Blumenstein v. Phillips Ins. Ctr., Inc., 490 P.2d 1213 (Alaska 1971) (depletion of debtor's assets not fraud per se, but creates a rebuttable presumption of fraud); KAN. STAT. ANN. § 60-713(d) (1983) (fraudulent transfer of attached property may be set aside); Koch Eng'g Co. v. Faulconer, 716 P.2d 180 (Kan. 1986) (conveyance made with fraudulent intent set aside); VT. STAT. ANN. tit. 9, § 2281 (1993) (fraudulent conveyances void); Stevens v. Hart, 356 A.2d 499 (Vt. 1976) (applying badges of fraud to infer intent).

Section 548, or may utilize applicable state law under the strong-arm powers of Section 544.[57] While certain substantive differences among the statutes may influence the trustee's choice of law, particularly in those jurisdictions in which the law follows a relatively limited Statute of Elizabeth approach, the primary factor in determining the most advantageous route to pursue may be the timing of the transfer. Section 548 applies only to transfers that occurred within one year of filing.[58] The U.F.T.A., on the other hand, permits challenge to a transfer four years after is made.[59] Given the requirement of insolvency for a showing of constructive fraud,[60] however, it may be considerably more difficult as a practical matter to attack a transfer that occurred several years before the bankruptcy than one made on the eve of filing.

1. The Question of Value. — The three principal statutes[61] all approach value from essentially the same analytical framework.[62] When the nature or quantum of value given in exchange for the allegedly fraudulent conveyance is in question, value must be considered from the viewpoint of the creditors, not the debtor.[63] This permits the constructive fraud analysis to be objective,

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57. "The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim . . . ." 11 U.S.C. § 544(b) (1993). The trustee may, of course, bring an action under both sections.

58. 11 U.S.C. § 548(a). An amendment to extend to two years the period in which the trustee can reach back and void fraudulent transfers was proposed in 1992, but failed to be included in final legislation. 138 CONG. REC. H11052-01, H11058 (1992).

This one year window is not actually a statute of limitations. The Code bars the filing of any action under the trustee's strong arm powers more than two years after the trustee's appointment, or after the case is closed or dismissed, whichever is earlier. 11 U.S.C. § 546(a).

59. U.F.T.A. § 9(a) (1984). An action may be brought up to one year after reasonable discovery, even if more than four years have passed. *Id.* Note, however, that some jurisdictions also add a statute of repose. *E.g.*, CAL. CIV. CODE § 3439.09(c) (West Supp. 1994) (seven year statute of repose). The U.F.C.A. does not provide for a uniform statute of limitations. U.F.C.A. (1918).

60. 11 U.S.C. § 548(a)(2)(B)(i); U.F.T.A. §§ 4(a)(2), 5(a); U.F.C.A. § 4.

61. U.F.C.A., U.F.T.A. and Section 548 of the Bankruptcy Code.

62. *In re* Chomakos (Allard v. Flamingo Hilton), 1995 WL 669522, *2 (6th Cir. Nov. 13, 1995); *see also In re* Otis & Edwards, P.C. (Webster v. Barbara), 115 B.R. 900, 908 (Bankr. E.D. Mich. 1990); *In re* Bates (Bates v. Two Rivers Constr.), 32 B.R. 40, 41 (Bankr. E.D. Calif. 1983); *In re* Curina Int'l, Inc. (Murdock v. Plymouth Enter., Inc.), 23 B.R. 969, 974 (Bankr. S.D.N.Y. 1982). This Comment will use the phrases "fair consideration" and "reasonably equivalent value" interchangeably.

63. *E.g.*, Larrimer v. Geeney, 192 A.2d 351, 354 (Pa. 1963) (U.F.C.A.); Hansen v. Cramer, 245 P.2d 1059, 1061 (Cal. 1952) (U.F.C.A.); United States v. West, 299 F. Supp. 661,

and to place emphasis on the underlying goal of fraudulent conveyance law: protection of creditors' claims. The question is whether the debtor received anything that has economic or material value. Obviously, exchanges for money or property are relatively easy to assess.[64] Reasonably equivalent value may also be found in such intangibles as legal services for the debtor,[65]or in the goodwill of the debtor's customers,[66] but may not be found in abstract non-commercial benefits such as love and affection given by a family member.[67]

The value given need not be property available for creditors to attach and levy, so long as it is economic in nature. In *Marine-Midland Bank—N.Y. v. Batson*,[68] decided under the U.F.C.A., the debtor conveyed real estate to his wife as part of a separation agreement, in exchange for the wife's waiver of her claim for alimony and support.[69] The court held that the waiver of alimony represented fair consideration, despite the fact that the debtor received no tangible assets.[70] Instead, the *Batson* court emphasized the financial nature of the exchange; the wife was, in essence, a creditor.[71] Her promise to forgo a claim against the debtor frees

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666 (D. Del. 1969) (U.F.C.A.); U.F.T.A. § 3 cmt. 2, 7A U.L.A. 651 (1985) ("Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition [of value]."); Clearwater v. Skyline Constr. Co., Inc., 835 P.2d 257, 267 (Wash. Ct. App. 1992), *cert. denied*, 848 P.2d 1263 (Wash. 1993) (U.F.T.A.); Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 991 (2d Cir. 1981) (applying Bankruptcy Act's "fair consideration" test); *In re* Minnesota Util. Contracting (First Nat'l Bank in Anoka v. Minnesota Util. Contracting, Inc.), 110 B.R. 414, 420 (D. Minn. 1990) (Section 548).

64. *E.g.*, *In re* 18th Ave. Dev. Corp., 18 B.R. 904 (Bankr. S.D. Fla. 1982) (applying Section 548 to sale of real estate); Brown v. Borland, 432 N.W.2d 13, 17 (Neb. 1988) (applying U.F.C.A. to exchange of one-half interest in house for assumption of debts).

65. *In re* Butcher (Martin v. Schledwitz), 69 B.R. 198 (Bankr. E.D. Tenn. 1986).

66. *In re* J.K. Chemicals, Inc., 7 B.R. 897 (Bankr. D.R.I. 1981).

67. *E.g.*, Fitzer v. Fitzer, 2 Atk. 511, 26 Eng. Rep. 708 (Ch. 1742) (Statute of Elizabeth); *In re* Treadwell (Walker v. Treadwell), 699 F.2d 1050, 1051 (11th Cir. 1983); United States v. West, 299 F. Supp. 661, 666 (D. Del. 1969); *In re* Compton, 70 B.R. 60, 63 (Bankr. W.D. Pa. 1987); *see also In re* Wheeler (Butz v. Wheeler), 17 B.R. 85, 87 (Bankr. S.D. Ohio 1981) (Transfer of tax refund from husband to wife in exchange for "past, present and future faithful performance of . . . household duties and parental responsibilities" is fraudulent.). *But see In re* Shader (Gayl v. Shader), 90 B.R. 85, 90 (Bankr. D. Del. 1988) (Suggesting that a debtor received reasonably equivalent value for the gift of a wedding ring to his bride: "Moreover, Ken received value for the ring—Lucie married him." It is not clear what fact finding the court conducted to determine that the value received was reasonably equivalent to the value of the ring.).

68. 332 N.Y.S.2d 714 (N.Y. App. Div. 1972).

69. *Id.* at 716.

70. *Id.* at 718.

71. *Id.*

up his capital, making it available for payments to his other creditors, or for the purchase of assets that they *could* attach.[72]

In dicta, the *Batson* court suggests that "fair consideration for a conveyance can be a consumable item which in ordinary use leaves over nothing."[73] This is certainly consistent with the body of fraudulent conveyance caselaw to the extent that such a consumable represents, for example, a meal which the debtor needs to sustain herself. This notion has been criticized, however, since it might be taken to mean that a "lavish feast" or a luxury vacation for the debtor would also represent fair consideration, despite the fact that it would provide no benefit from the point of view of the creditors.[74] Notwithstanding arguments that a debtor's financial productivity is enhanced by rest and relaxation, the purchase of a luxury item such as an expensive meal or a vacation in Paris is an exchange that is economic in nature: the items bought have an easily discernable fair market value, and are commonly purchased. This may merely point to the practical limit of the creditor's-point-of-view approach. If the debtor buys a tank of gas at market price, it seems commonsensical to treat that as an exchange for fair consideration, whether she uses that gas to drive to work or for a Sunday afternoon drive in the country.[75]

In re Chomakos[76] addresses just such a problem. There, the debtor had lost $7,710 gambling at a casino in the year prior to

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72. *See also In re* Treasure Valley Opportunities, Inc. (Krommenhoek v. Natural Resources Recovery, Inc.), 166 B.R. 701 (Bankr. D. Idaho 1994) (executory promise can be reasonably equivalent value, if of financial value to creditors).

73. *Batson*, 332 N.Y.S.2d at 717.

74. ALCES, *supra* note 42, at 5-61.

75. Professor Jack F. Williams, in discussing the question of reasonably equivalent value in the context of an exchange for services, suggests that when a debtor owns an office building, her creditors would see no economic benefit from the debtor's hiring companies to perform such services as washing the windows, shampooing the rugs, and maintaining the grounds. Jack F. Williams, *The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties*, 15 CARDOZO L. REV. 1403, 1423-24 (1994). This example clearly takes too narrow a view of benefit to creditors. When the debtor owns an office building, the income she receives in rent from tenants is dependant in part upon her performing her obligations as landlord. If she neglects to fulfill her obligation to maintain the premises, the tenants may be entitled to withhold their rents. Such a reduction in the income of a bankrupt's estate would clearly harm the interests of creditors.

Professor Williams seeks to resolve this problem by redefining the law of constructive fraud in terms of transactions in the ordinary course of business. For a discussion of this proposition, see *infra* text accompanying notes 95-97.

76. (Allard v. Flamingo Hilton), 170 B.R. 585 (Bankr. E.D. Mich. 1993), *aff'd*, 1995 WL 669522 (6th Cir. Nov. 13, 1995).

filing bankruptcy.[77] The chapter 7 trustee sought to recover the debtor's losses from the casino as fraudulent transfers under Section 548 and under the Uniform Fraudulent Conveyance Act, arguing that the debtor did not receive reasonably equivalent value in exchange for his lossess.[78] The court ruled that the debtor did receive fair consideration, treating the gambling as entertainment, for which the debtor paid a fair price.[79] The *Chomakos* court criticized the proposition that the analysis of value should be limited solely to value from the creditor's viewpoint: "[I]f the debtors treated themselves to $250 meals each day for a month, their estate would be depleted by $7,000 but consideration would still be present."[80] The court based its ruling instead on the fact that the gambling losses were the result of commercially reasonable, arm's-length transactions.[81] A contrary decision, the court argued, would place an untenable burden on the casino, which was, after all, simply engaging in a legal business enterprise.[82]

Underlying the *Chomakos* case is an aversion to placing the burden of debtor irresponsibility on the casino. Some response to the debtor's excessive spending may be appropriate; it conflicts with our notions of debtor rehabilitation and fair treatment of creditors for an insolvent debtor to throw away seven thousand dollars at a casino or to treat herself to a vacation in Paris. It is for this reason that the Bankruptcy Code excepts from discharge debts over one thousand dollars incurred in the forty days prior to bankruptcy for luxury goods or services.[83] It is irresponsible for debtors to spend their money in such a manner, and such a debtor coming to the bankruptcy court and requesting a discharge from her financial obligations may fairly be said to come to a court of equity with unclean hands.

The *Chomakos* court balked at the remedy proposed by the trustee. While it may be wrong for an insolvent debtor to fly to Paris on the eve of bankruptcy, can we fairly demand that the airline disgorge the money it was paid for the flight? Viewed in this light, the remedy for constructive fraud against transferees may

77. *Id.* at 590.
78. *Id.* at 587.
79. *Id.* at 584.
80. *Id.* at 592.
81. 170 B.R. at 593.
82. *Id.* at 595-96.
83. 11 U.S.C. § 523(a)(2)(C) (Supp. 1995).

be seen to be based on the principle that the transferee should not be allowed to benefit from the debtor's generosity when other creditors are forced to accept no payment at all. When the transferee gave commercial fair market value in goods or services in exchange for payment at market prices, it seems unjust to demand disgorgement simply because the debtor was irresponsible in purchasing those goods or services. This is not, after all, a question of the debtor being generous to the transferee before being just to her creditors; it is, instead, a question of debtor irresponsibility. A remedy that focuses on the debtor's wrongdoing, such as denial of discharge,[84] may be better suited to such a situation, even though it may offer little solace to creditors whose claims remain unpaid.[85]

The problem with the *Chomakos* decision is that its emphasis on the transferee's role in the exchange is unsupported by caselaw or by statute. The traditional approach has been to answer the consideration question based on value from the creditor's viewpoint.[86] *Chomakos* seeks to exempt from constructive fraud attack arm's-length, commercially reasonable transactions. While this may seem like an appropriate equitable defense, it is not a defense rooted in precedent.

2. *The* BFP *Decision and the Value Issue.* — The Supreme Court implicitly affirmed the *Chomakos* solution in *BFP v. Resolution Trust Corp.*[87] The *BFP* decision resolved a circuit split over whether the price obtained on real estate in a foreclosure sale represents reasonably equivalent value if it is considerably lower than the fair market value of the property. The issue first arose in

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84. Section 727(a)(2) provides that the court may deny discharge in a chapter 7 proceeding when:

> [T]he debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated or concealed—
>
> (A) property of the debtor, within one year before the date of the filing of the petition . . . .

11 U.S.C. § 737(a)(2).

85. The problem with applying Section 727 to prevent debtor irresponsibility is, of course, that the debtor may have acted without intent to harm her creditors. *See infra* part III.D.

86. *See supra* note 63.

87. 114 S. Ct. 1757 (1994).

Durrett v. Washington National Insurance Co.,[88] in which the Fifth Circuit declared that a pre-bankruptcy foreclosure sale for less than seventy percent of market value is per se a voidable fraudulent transfer under Section 548.[89] Three approaches to the question arose following the *Durrett* decision, one following its reasoning,[90] the second analyzing foreclosures on a case-by-case basis with a presumption that a foreclosure sale price is reasonable,[91] and the third stating that the price received at a non-collusive, regularly conducted foreclosure sale is reasonably equivalent value as a matter of law.[92] The Supreme Court in *BFP* endorsed the third approach, holding that, "a 'reasonably equivalent value . . .' for foreclosed property . . . is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with."[93]

The application of the *BFP* ruling to circumstances other than foreclosure on real estate is necessarily limited; the Court cautions in its decision that it "covers only mortgage foreclosures of real estate."[94] An analogy to the quandary raised by *Chomakos* is nonetheless helpful. The *BFP* decision suggests that when a transaction is made in proper form and at arm's length, we may take as a given that the consideration is reasonably equivalent value for fraudulent transfer purposes. Like *Chomakos*, the *BFP* decision expresses concern that a contrary ruling would place an undue burden on the transferee: "[T]he title of every piece of realty purchased at foreclosure would be under a federally created cloud."[95] The Court emphasizes that the question of value must take into consideration the circumstances under which the transfer

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88. 621 F.2d 201 (5th Cir. 1980).

89. *Id.* at 204.

90. *E.g.*, *In re* Wheeler (Federal Nat'l Mortgage Ass'n v. Wheeler), 34 B.R. 818 (Bankr. N.D. Ala. 1983); *In re* Berge, 33 B.R. 642 (Bankr. W.D. Wis. 1983); *In re* Thompson (Wickham v. United Am. Bank), 18 B.R. 67 (E.D. Tenn. 1982).

91. *E.g.*, *In re* Bundles, 856 F.2d 815 (7th Cir. 1988); *In re* Grissom, 955 F.2d 1440, 1445-46 (11th Cir. 1992); *see also In re* Littleton, 888 F.2d 90, 92 n. 5 (11th Cir. 1989).

92. *In re* Madrid (Lawyers Title Ins. Co. v. Madrid), 21 B.R. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984); *In re* Verna (Verna v. Dorman), 58 B.R. 246 (Bankr. C.D. Cal. 1986); *see also In re* Winshall Settlor's Trust, 758 F.2d 1136, 1139 (6th Cir. 1985).

93. 114 S. Ct. at 1765.

94. *Id.* at 1716 n.3.

95. *Id.* at 1765. The *BFP* court noted that many title insurers had already created exceptions in their policies to insulate themselves from *Durrett* actions. *Id.*

is made: forced sale will necessarily reduce a house's worth.[96] It is the regularity of the foreclosure sale that allows this reduction in value to comport with the reasonably equivalent value requirement of Section 548. The Court suggests that *BFP* would not apply to a foreclosure sale *not* conducted according to state law. In such circumstances, the factfinder must conduct a traditional inquiry into the question of whether the value given was in fact reasonably equivalent to the property sold.[97] This idea could perhaps be extended to suggest that only when, in a *Chomakos* situation, the parties are not dealing at arm's length and under ordinary commercial circumstances, will it be appropriate to examine the value of the consideration given to the debtor. Thus, a court would examine the question of reasonably equivalent value when the debtor sells her car to her brother, but not when she sells it to a dealership.[98]

The *BFP* formulation provides a solution more compatible with traditional fraudulent conveyance doctrine than that offered by Professor Jack F. Williams.[99] Professor Williams suggests that the problem of value exchanged by the debtor for goods or services that do not benefit creditors can be avoided by recasting the inquiry in terms of transactions in the ordinary course of business. Williams argues:

> [T]he purpose [of the law of fraudulent conveyances] is to prevent the *unjust* diminution of a debtor's estate at the expense of its creditors. Thus, some, even a significant, diminution to the estate available to one's creditors is legally acceptable. What, then, does "unjust" mean in these circumstances? It means that the diminution, that is, the damage to

96. *Id.* at 1767.

97. *BFP*, 114 S. Ct. at 1765.

98. The flaw with the *BFP* solution to the mortgage foreclosure issue is that it is fundamentally unfair to the creditors. Under *BFP*, if a $500,000 house sells for $50,000 (the amount of the mortgage) at a properly conducted foreclosure sale, the buyer gets a windfall and the creditors must accept the loss of $450,000 of the estate's equity. Although the *BFP* dissent objects that such a result is inconsistent with the language of Section 548, *BFP*, 114 S. Ct. at 1767, Congress has shown a reluctance to clarify the issue. 130 CONG. REC. S13771-S13772 (daily ed. Oct. 5, 1984) (statements of Senators DeConcini & Dole). *But see* 133 CONG. REC. S8050-03 (daily ed. June 11, 1987) (statement of Senator DeConcini) (proposing an amendment repudiating *Durrett*, which has not become law). We must regard *BFP* as a modification of the definition of "reasonably equivalent value."

99. Williams, *supra* note 75.

> creditors, arises from a transaction or event outside the ordinary course of affairs of a debtor—an unexpected harm.[100]

Williams proposes that any transfers made by a debtor that are habitual and regular would be anticipated by her creditors, and therefore should not be viewed as fraudulent, even if voluntary.[101]

This solution falls short of satisfaction in a number of respects. First, it would leave a transferee like an airline, which gave consideration of equivalent value in exchange for the purchase price from the debtor, liable for that transaction as fraudulent unless the debtor flew to Paris habitually. Such a result makes no sense in an inquiry that purports to look for the adequacy of consideration. Secondly, while creditors may be aware of such habitual transfers, they may assume that the transfers bear some relationship to the debtor's financial condition. When a creditor agrees to make a loan, knowing that the debtor regularly gives money to charity, the creditor may assume that the debtor makes such donations based on her ability to pay. Regardless of how much a debtor spent on Christmas presents in previous years (while solvent), a creditor may well feel that once the debtor becomes insolvent, it would be unjust for her to cease to make loan payments in order to spend hundreds of dollars on gifts. Williams' proposition that we depart from 300 years of fraudulent conveyance tradition in favor of an ordinary course of business rule fails to resolve the inherent inconsistencies in the subject nearly as elegantly as would an extension of the *BFP* approach.

C. Voluntary Transfers

The calculus changes when the transfer in question is not a commercial purchase, but a gift. Voluntary transfers are among the oldest forms of fraudulent conveyance, particularly when made among family members.[102] The close relationship between donor and donee permits a ready assumption that fraudulent intent may be present; a gift from husband to wife, which leaves the husband free to enjoy the property as if it were still his, seems highly suspicious when it occurs after the husband's financial condition has deteriorated to the point that the property would be in danger of

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100. *Id.* at 1424 (emphasis added).

101. *Id.*

102. *E.g.*, Colville v. Parker, Cro. Jac. 158, 79 Eng. Rep. 138 (K.B. 1608); Townshend v. Windham, 2 Ves. Sen. 1, 28 Eng. Rep. 1 (Ch. 1750).

attachment by his creditors. Even if the question of fraudulent intent is removed, permitting such a transfer would be inequitable as to the husband's creditors, since the husband is still free to use the property, while the creditors' attempts to recover the money owed to them are frustrated.[103]

Likewise, a gift from a debtor to her children or close friends may be taken as either an attempt to shield the property from creditors while keeping it within the debtor's reach, or as an attempt to dispose of it in a manner that is unjust as to her creditors. Even if the transfer was made with no intent to defraud, the debtor should still be just before she is generous.[104]

1. Charitable Donations. — Voluntary transfers to charitable organizations offer a similar dilemma, and one which creates problems for both the creditor's point of view and the arm's-length transaction tests of reasonably equivalent value. When a debtor gives money to a charity, her creditors certainly see a diminution in the debtor's assets that are available for levy. There does not appear to be an indirect benefit in such a transaction, as there is in the purchase of consumables necessary for the debtor's sustenance. A suggestion that the creditors benefit indirectly because society is made better by the support of worthy charities seems farfetched; besides, it is clear that the consideration received in exchange for the transfer must be reasonably concrete.[105]

If there is no value received from the creditor's point of view, what value does the debtor see as realized from the exchange? Charitable donations may be business as usual for many debtors and for our society,[106] but this is not a commercial exchange for value in the same way as the purchase of a tank of gas. Individuals may sometimes receive tangible benefits in exchange for their support for certain causes: if you give to public radio, you may get

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103. There is some overlap between such transfers and the conversion of nonexempt property to exempt property immediately prior to filing a bankruptcy. *See* Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615 (1978).

104. *See supra* note 11.

105. *In re* Minnesota Util. Contracting, Inc. (First Nat'l Bank in Anoka v. Minnesota Util. Contracting), 110 B.R. 414, 420 (D. Minn. 1990); Zahara Spiritual Trust v. United States, 910 F.2d 240, 249 (5th Cir. 1990).

106. Professor Williams would find that such transfers are not fraudulent conveyances so long as they are part of a regular pattern of charitable giving. Williams, *supra* note 75, at 1424-25; *see supra* text accompanying notes 95-97.

a magazine subscription or a mug; if you support a museum, you may be allowed free admission. It is, however, essential to the notion of gifts in support of charities that the "welcome gifts" do not eat up all of a member's donation. These perks are designed to make giving more attractive, but they are clearly not the main "consideration" for supporting a charity; otherwise, the exchange would not be a charitable donation. It would be a purchase.[107] The Supreme Court has affirmed this notion unequivocally: "The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration."[108]

The decision in *1992 Republican Senate-House Dinner Committee v. Carolina's Pride Seafood*[109] (hereinafter *GOP Dinner*) presents an example of just such a transaction. The debtor, Soon Kojima, gave a $500,000 donation to a political organization in order to obtain a seat at the President's table at a fund-raising dinner.[110] It was clear that the debtor regarded this as an exchange for the privilege of sitting with the President, and not merely as a gift; he raised is donation from $400,000 to a half-million when he was told that he would be seated with Vice-President Quayle.[111] Kojima's donation turned out be an embarrassment for the dinner's organizers when his ex-wife began to complain to the press that he was delinquent in child support payments, regardless of his political generosity.[112] Kojima's creditors claimed a superior right to the funds, alleging that the donation was constructively fraudulent under the U.F.C.A.[113]

The court took it as a given that the tangible consideration for Kojima's donation was minimal; there was no suggestion that the meal itself was worth $500,000.[114] The dinner's organizers argued that the debtor received intangible benefits such as "'the value that

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107. Such transactions are treated as having a "dual character" for federal tax purposes; they represent a purchase to the extent of the fair market value of the item received by the donor, with the remainder of the transfer being treated as a charitable donation. United States v. American Bar Endowment, 477 U.S. 105, 117 (1986).

108. *Id.* at 118 (addressing the income tax deductibility of insurance premiums paid to a non-profit organization).

109. 858 F. Supp. 243 (D.D.C. 1994).

110. *Id.* at 245.

111. *Id.*

112. *Id.* at 245-46.

113. The district court, presiding over the case in diversity jurisdiction, found that California law applied as to the fraudulent conveyance claims. *Id.* at 248.

114. *GOP Dinner*, 858 F. Supp. at 249.

comes from supporting sound governmental policies,' invitations to various events, and the opportunity to sit at the head table."[115] The court, clearly disgusted with the suggestion that a dollar value could be placed on sound government and the President's company (let alone the idea that such things are for sale), rejected this reasoning: "Plaintiff's description of the rewards ensuing to contributors is tawdry and cynical."[116] The transfer was held to have been made without reasonable consideration, and therefore to be fraudulent as to Kojima's creditors.[117]

While *GOP Dinner* is wholly consistent with the principle that there is no reasonably equivalent value unless the debtor receives some tangible benefit, how is it to be harmonized with *BFP's* suggestion that a legal, commercially reasonable arm's-length transaction should not be violated? Under the reasoning of *Chomakos*, Kojima's donation might be regarded as an entertainment expense. After all, one would expect eating diner with the President to cost more than gambling at the Flamingo.

From a creditor's viewpoint, the *Chomakos* and *GOP Dinner* transactions look the same; neither brings anything tangible back into the estate.[118] The debtor in both cases may feel that he "got" something from the exchange: excitement, opportunity, emotional satisfaction, pleasure. The distinction that motivated the *Chomakos* court to protect the debtor's gambling loses was that the money spent at the casino was spent in a commercial exchange. There is an element of purchase, of bargained-for exchange, present in money spent on an activity that is labeled as entertainment, which is not present when one receives emotional satisfaction

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115. *Id.*

116. *Id.*

117. *Id.*

118. While one might argue that Kojima's substantial support of the GOP could lead to legislation that would directly benefit his business interests, resulting in financial benefit from the viewpoint of his creditors, the suggestion that this is an "exchange" offends not only our notion that policy is not for sale (A notion that some, admittedly, would dispute. *See, e.g.*, AMATI ETZIONI, THE RESPONSIVE COMMUNITY 209-25 (1993).), but also our notion of logical causation. Kojima's contribution may help advance political causes that benefit him, but the causal relationship between his donation and the economic benefit is indirect at best. To borrow language from the law of negligence, we might say that while the donation is *a* cause in fact of the economic benefit, it is not *the* proximate cause; the connection is simply too tenuous. *See* Palsgraf v. Long Island R.R. Co., 162 N.E. 99, 101-05 (N.Y. 1928) (Andrews, dissenting).

from giving to charity.[119] The pleasure derived from a purchase (in theory, at least) comes from the item purchased; it is not the act of buying that justifies most purchases, but the thing bought. The satisfaction of giving to charity comes from the gift itself. You can enjoy the museum merely by paying an admission fee and touring it; people give money to that museum because they derive some emotional benefit from the act of supporting it. In this sense, the distinction is based upon the notion of *exchange*. Chomakos got some emotional reward in exchange for the money he spent gambling. Kojima (in theory) got his emotional reward from the fact that he had given his support to a cause he saw as worthy.

Kojima, however, appears to have been motivated, at least in part, by the benefit directly resulting from his gift; he didn't just want to support the cause, he wanted to buy a seat at the President's table. Other charitable givers might also be motivated by a perceived increase in social status resulting from philanthropy, or by a narcissistic desire to see the new gym at their alma matter named for them. One problem with drawing distinctions on this basis is that looking into such motivations returns the analysis to the evidentiary problem that an objective law of constructive fraud sought to escape. How is a court to discern the debtor's motivation in making the gift, particularly if the debtor is willing to lie in order to keep her name on the new gym (or out of a reluctance to admit her egotism)?[120]

Valuation poses a thornier problem. Even if we accept the notion that the debtor receives value in the form of emotional gratification in exchange for her donation, how are we to determine

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119. *See In re* Chomakos (Allard v. Flamingo Hilton), 1995 WL 669522, *4 (6th Cir. Nov. 13, 1995).

A distinction may be drawn from David Carlson's suggestion that some gratuitous transfers, such as restaurant tips and shareholder dividends, are not fraudulent conveyances. David G. Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. 643, 655 n. 50 (1987). While a diner has no legal obligation to tip a waiter, there is still a commercial element to the transaction. Waiters expect to receive tips as part of their compensation; diners expect to pay a tip as part of the cost of the meal. The tip is, in essence, exchanged for better service. While there is certainly no value here from a creditor's point of view, an extension of the *BFP* rule would protect tipping as an arm's length, commercially reasonably transaction.

Further support for Professor Carlson's proposition may be found in the treatment of tips an income, rather than gifts, for federal tax purposes. Treas. Reg. § 1.61-2(a) (as amended in 1989).

120. These two lies would lead to opposite results, precisely the reason that we want to avoid subjective inquiry into the transferor's motivations (absent actual intent to defraud).

whether that value is reasonably equivalent to what was given? The *Chomakos* court could assume reasonably equivalent value, since in an arm's-length commercial transaction, the value of the product or service is generally defined by the market price.[121] When the exchange is one of donation for emotional reward, what is the fair market value of the emotional reward?[122] While a public radio station may offer memberships at $35, $60 and $120,[123] a listener can not necessarily assume that the satisfaction derived from a $120 membership is truly twice the "value" of a $60 membership.[124] There is not really a "market price" for a donation; there is only a recommended gift. Fundamentally more disturbing is the notion of placing dollar values on the satisfaction derived from supporting worthy causes. Just as it offends notions of how government should work to suggest that Kojima purchased "sound policy," if offends notions of religious belief to suggest that by tithing a church member purchases spiritual peace.

2. Religious Donations. — These flaws undermine decisions that seek to protect donations to churches as exchanges for reasonably equivalent value. The argument most easily refuted is that the spiritual benefit of worship represents consideration for tithes.[125] The Fifth Circuit considered such a claim in *Zahra Spiritual Trust v. United States*,[126] an action under the U.F.C.A.[127] The *Zahra* court rejected the debtor's argument that the transfer of certain real property to a religious trust was made for valuable consideration because the debtor received in exchange "spiritual fulfillment."[128] The court ruled that "[t]he relevant inquiry under [the U.F.C.A.] is whether the debtor received monetary, not spiritual,

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121. *E.g.*, BLACK'S LAW DICTIONARY 1551 (6th ed. 1990) (Value may mean "the amount of money which the property will command in exchange, if sold, this being called its 'market value.'").

122. The problems inherent in applying *BFP's per se* value rule to charitable donations are discussed below at *infra* part II.C.3.

123. WITF-FM Harrisburg (Pennsylvania) fund-raising broadcast (radio broadcast, week of October 17, 1994).

124. *See also In re* Newman (Morris v. Midway S. Baptist Church), 183 B.R. 239, 247-48 (Bankr. D. Kan. 1995) (rejecting the proposition that an increased spiritual return will result from increased tithing).

125. In this discussion, "tithe" will mean contributions to a church, regardless of whether or not they constitute ten percent of the contributor's income.

126. 910 F.2d 240 (5th Cir. 1990).

127. *Id.* at 247.

128. *Id.* at 248.

consideration."[129] After all, the essence of a gift is that the giver makes it because she gains some sense of emotional satisfaction from the act of giving. If a donor can be said to tithe in exchange for equivalent emotional value, then *all* gifts would be supported by "consideration" of the same sort. Like the *GOP Dinner* court, the Fifth Circuit was not about to treat such an exchange as a sale and attempt to place a dollar value on the spiritual reward felt by one who gives.[130]

The inquiry becomes more complex when there is more to the transfer than the mere joy of giving. In *In re Missionary Baptist Foundation of America, Inc.*,[131] the debtor, a charitable foundation, gave $17,000 in monthly payments to a church organization in the year prior to its bankruptcy.[132] The trustee sought to avoid these transfers as fraudulent under Section 548.[133] The bankruptcy court acknowledged the clear absence of any tangible consideration for the contributions, in the form of either services or other "monetary equivalent."[134] Nonetheless, the court ruled that the transferee gave reasonably equivalent value in the exchange.[135] Reasoning that Section 548(a)(2)(A) "does not appear to require that 'reasonably equivalent value' be a monetary equivalent,"[136] the court held that the debtor, as a non-profit organization incorporated in part for the purpose of making charitable contributions, received value in the form of good will, preservation of

129. *Id.* at 249.

130. *See also Newman*, 183 B.R. at 246 n. 10 ("The defendant made some vague references to the debt that the debtors owed to God. However, any such obligation is beyond the jurisdiction of this Court to determine. Assuming the debtors feel so obligated, the obligation does not constitute a debt as that term is used in the Bankruptcy Code.").

131. (Wilson v. Upreach Ministries), 24 B.R. 973 (Bankr. N.D. Tex. 1982).

132. *Id.* at 974-75.

133. *Id.*

134. *Id.* at 979 ("No one can argue that MBFA [the debtor] received a monetary equivalent for the payments which were made by it to Upreach Ministries during that twelve month period. There was no proof whatsoever that [the transferee] performed any services which arguably could constitute 'reasonably equivalent value' to MBFA. Certainly Upreach Ministries furnished nothing tangible to MBFA.").

135. *Id.*

136. 24 B.R. at 979.

employee morale,[137] and the fact of compliance with the mandate of its incorporators.[138]

While it is probably true that these factors influenced the debtor's decision to make the contributions despite its insolvency, they do not appear to represent value as traditionally applied in fraudulent conveyance cases. It is highly questionable, in fact, whether the debtor can truly be said to have received these benefits from the transferee; making the donations may have made the debtor's officers and employees feel good, but that does not make this transaction an exchange of money for good feelings. More importantly, there is no basis for treating good feelings as reasonably equivalent value. contrary to the *Missionary Baptist* court's conclusion, Section 548(d)(2)(A) defines value as "property, or satisfaction or securing of a present or antecedent debt of the debtor . . . ."[139] While "reasonably equivalent" is not expressly defined as monetary equivalent, it seems clear that the value contemplated *is* economic value; the consideration the *Missionary Baptist* court uses as a basis for its decision is not "property" in any conventional understanding of the term.

A similar analytical problem arises when the debtor receives benefits from membership in the charity to which she gives.[140] The debtors in *In re Moses*[141] were parishioners who gave approximately $4,700 to their church in the year preceding their bankruptcy.[142] The bankruptcy court denied the trustee's motion to void the donations as fraudulent transfers, holding that the debtors

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137. It is ironic that while the *Missionary Baptist* transfers were found not to be fraudulent in part due to the debtor's need to make them in order to maintain employee morale, separate litigation makes clear that the debtor was so zealous in its charitable donations that it overdrew its bank accounts and wrote bad payroll checks to its employees. *In re* Missionary Baptist Found. of Am., 667 F.2d 1244 (5th Cir. 1982).

138. *Missionary Baptist*, 24 B.R. at 979.

139. 11 U.S.C. § 548(d)(2)(A) (1993). "Satisfaction" in this definition clearly refers to satisfaction "of a present or antecedent debt," not to emotional satisfaction.

140. An interesting contrast may be found in Tracy v. Hahn, 940 F.2d 1536 (Table), 1991 WL 148926 (9th Cir. 1991), a case not directly involving fraudulent conveyance issues. The Tracys, defendants in a criminal action, were "High Priest and Priestess of The Church of the Most High Goddess, a 'hedonistic' religion whose principal rites require adherents to tithe and engage in oral and vaginal sex with the clergy." 1991 WL 148926 at **1. They were convicted of keeping a house of ill repute. One can only speculate whether a member of The Church of the Most High Goddess could successfully argue that he or she received reasonably equivalent value in exchange for his or her tithing.

141. (Ellenberg v. Chapel Hill Harvester Church, Inc.), 59 B.R. 815 (Bankr. N.D. Ga. 1986).

142. *Id.* at 816.

received reasonably equivalent value in exchange for their tithes, in the form of counseling services, personal contacts, and the provision of utilities during church services.[143] The court concluded that while "nothing tangible was given to the Debtors in exchange for the tithes and offerings,"[144] the services provided by the church represented property.[145] The debtors had availed themselves of free marriage counseling, which the court reasoned was the equivalent of expensive private counseling.[146] The church also supplied the debtors with informal contacts with potential employees for their business, and with information on developments in the building and construction trades, presumably through the debtors' contacts with other members of the congregation.[147] The debtors also received the benefit of heating, air conditioning, and electricity while in the church building for services. The court held that, since the church must pay for such utilities, and since it relies on tithes and offerings to cover these operating expenses, the debtors tithed in exchange for the enjoyment of these utilities.[148]

Unlike the value cited by the court in *Missionary Baptist*, the items of reasonably equivalent value identified by the *Moses* court have an identifiable value; one could calculate the cost of 80 hours of professional counseling or the pro-rated cost of utility service expended per worshiper present during each church service. Like the *Missionary Baptist* court, however, the *Moses* court bases its conclusion on the highly dubious proposition that the benefits received by the debtors from the church were given in exchange for the donations in question.[149] It is certainly true that the church provided utility service while the debtors were inside. However, their receipt of such service was not dependent upon their tithing, or upon the amount of their tithing. The same heating, air conditioning, and electricity benefited everyone in the building at

143. *Id.* at 818-20.

144. *Id.* at 818.

145. *Id.*

146. This counseling was of value to the debtors, since they would have had to pay for such counseling had they sought it out from a private counselor, and also because it resulted in actual benefit to them: "The Debtors testified at trial that such services assisted them in getting through an extremely difficult period of their lives prior to bankruptcy." 59 B.R. at 818.

147. *Id.* at 819. The *Moses* court does not clearly explain the nature of this "informal counseling."

148. *Id.* at 818-19.

149. *Id.* at 818.

the time, regardless of whether they had given money to the church. Likewise, the informal business contacts that the debtors enjoyed as members of the congregation were incidental benefits of membership, not value given to the debtors by the church. The debtors had the opportunity to meet other churchgoers regardless of how much they gave. These informal contacts might be likened to the debtor's opportunity to eat with the President in *GOP Dinner*; while such social contacts might be of some value to the debtors, they do not have an ascertainable dollar value that can be compared to the amount of the donation to determine reasonable equivalence.

The counseling services cited by the *Moses* court more closely approximate the sort of consideration for which a reasonably equivalent value analysis is appropriate. Similar counseling by a professional in private practice[150] would have a specific cost. One might argue that the counseling received by the debtors is "worth" whatever it would have cost them to obtain such counseling on the open market. The flaw with the conclusion that such services are reasonably equivalent value is in the *Moses* court's assumption that there was an exchange. It appears that the church provided free counseling to its members;[151] all members were asked to make contributions in order to help defray the cost of operating the church.[152] There was no suggestion that all church members received counseling, or that those who did avail themselves of the counseling services gave more as a consequence. While the church's ability to provide such services was undoubtedly dependant upon the generosity of its congregation, the church was not "selling" those services in exchange for tithes.[153] It is likely that, for tax and liability reasons, neither the church nor the debtors would want the provision of counseling services to parishioners to be treated as the sale of professional services.[154]

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150. The *Moses* court describes the training of the counselors at the debtors' church as "theological." *Id.* at 818. The court clearly assumes that the counseling received by the debtors was equivalent to that which they would have received had they sought private counseling.

151. *Moses*, 59 B.R. at 816.

152. *Id.*

153. *See also Newman*, 183 B.R. at 248.

154. Hernandez v. Commissioner, 490 U.S. 680, *reh'g denied*, 492 U.S. 933 (1989) (charitable contributions may not be deducted from income if made in exchange for specific services); I.R.C. § 501(a), (c) (West 1994) (exempting from taxation religious and charitable institutions); *see infra* part III.A.2 (charitable immunity).

Both the *Missionary Baptist* and the *Moses* decisions are criticized by the District Court for the District of Minnesota in *In re Young*.[155] The debtors in *Young* donated $13,450 in tithes to their church in the year preceeding their bankruptcy.[156] The trustee sought to recover the transfers as fraudulent under Section 548.[157] The court held that the tithes were constructively fraudulent, ruling that "[a] debtor cannot receive reasonably equivalent value for payments that are made out of a sense of moral obligation rather than legal obligation."[158] Applying the principle that fraudulent conveyance law is intended "to prevent the debtor from depleting the resources available to creditors through gratuitous transfers of the debtor's property,"[159] the court concluded that religious donations, like interfamilial gifts, "are clearly avoidable."[160]

The *Young* court rejected the church's argument that the debtors received reasonably equivalent value through the opportunity to claim a tax deduction for their tithes.[161] Under the Supreme Court's decision in *Hernandez v. Commissioner*, [162] a charitable donation may not be taken as a deduction from income for tax purposes if it is made at a fixed amount in exchange for specific services.[163] The *Young* court reasoned that, "by definition if a charitable contribution is deductible, *i.e.*, without adequate consideration, it cannot be in exchange for 'reasonably equivalent value,'"[164] Moreover, the value of a tax deduction for a charitable contribution can not be reasonably equivalent in value to the deduction itself. Such an argument presupposes that the income tax rates are so high as to be equivalent in value to the income being taxed.[165]

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155. (Christians v. Crystal Evangelical Free Church), 152 B.R. 939 (D. Minn. 1993).

156. *Id.* at 943. The Youngs continued to give ten percent of their income to their church, even as their electrical contracting business faltered. Laurie Goodstein, *Religious Groups Fight U.S. in Bankruptcy Case*, WASH. POST, May 23, 1994, at a1.

157. *Young*, 152 B.R. at 944.

158. *Id.* at 948.

159. *Id.* at 949 (quoting Walker v. Treadwell (*In re* Treadwell), 699 F.2d 1050, 1051 (11th Cir. 1983)).

160. *Id.*

161. *Id.*

162. 490 U.S. 680, *reh'g denied*, 492 U.S. 933 (1989).

163. *Id.* at 691-92.

164. *Young*, 152 B.R. at 949.

165. The absurdity of arguments by tax protestors that this is so is evidenced by the fact that citizens of the United States have one of the lowest tax burdens in the industrialized

The *Young* court further rejected the proposition that any value that the debtors may have received was in exchange for their donations. Given that the church provided support and services to all regardless of contribution, the provision of such benefits to the debtors can not be in exchange for their tithes.[166]

3. Application of the BFP *Approach to Charitable Donations.* — Traditional fraudulent conveyance doctrine clearly offers no solace to the churches in these cases. As the *Young* court concluded, the rulings on behalf of the transferees in *Missionary Baptist* and *Moses* appear to be the result of courts misapplying the law in order to reach the "right" conclusion.[167] It is not clear, however, that the application of *BFP*,[168] by extending its ruling to all arm's-length commercially reasonable transactions provides any protection for the recipients of charitable contributions from insolvents.

An extension of *BFP* that would cover circumstances such as those faced by the *Chomakos* court[169] would not necessarily help charitable institutions that have received allegedly fraudulent conveyances. Essential to *BFP's* per se value rule is the notion of market exchange; the price obtained at a foreclosure sale is reasonably equivalent value because it is the product of market forces.[170] The *BFP* transaction is not fraudulent because it is a commercial exchange, conducted at arm's length in a customary and commercially reasonable manner.

Such a reading of *BFP* would not apply to charitable donations. Essential to the idea of a donation is that it is *not* a commercial exchange.[171] A rule that protects arm's-length commercial transactions does not, by its plain language, extend to gratuitous transfers, whether made in a personal context (such as

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world. Martin J. McHahon, Jr., *Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself*, 50 WASH. & LEE L. REV. 459, 464 (1993) ("No important industrialized democracy has a lower tax burden, and many have significantly higher taxes.") (citing LESTER THUROW, HEAD TO HEAD: THE COMING ECONOMIC BATTLE AMONG JAPAN, EUROPE, AND AMERICA 269 (1992)).

166. *Young*, 152 B.R. at 949; *see also Newman*, 183 B.R. 239 (the "factual twin" of the *Young* case, expressly following the *Young* court's analysis and conclusions).

167. *Young*, 152 B.R. at 949-50.

168. BFP v. Resolution Trust Corp., 114 S. Ct. 1757 (1994); *see supra* part II.B.2.

169. *See supra* notes 76-86 and accompanying text.

170. *BFP*, 114 S. Ct. at 1762.

171. *See* Hernandez v. Commissioner, 490 U.S. 680, *reh'g denied*, 492 U.S. 933 (1989); United States v. American Bar Endowment, 477 U.S. 105, 117 (1986).

gifts to family members) or in a formal, "business" context (such as contributions to a charity). Charitable contributions certainly can be conducted at arm's length; many donations are made to causes by individuals whose only contact with the charity is the gift. An arm's-length transaction does not, however, inherently render an exchange commercial in nature. The extended *BFP* rule establishes that the *value received* in a commercially reasonable exchange is reasonably equivalent to the price paid.[172] This does *not* suggest that all reasonable exchanges are per se exempt from attack under Section 548. Rather, *BFP* establishes a rule regarding the equivalency of value, where an exchange has been made for value, but the relationship between the value received and the value given is in question. As discussed above,[173] the fatal flaw in the arguments offered by the churches in *Zahara, Missionary Baptist, Moses*, and *Young* is that *no* value is received in exchange for a purely gratuitous donation. There are no grounds for applying the extended *BFP* value rule when there in no value given.

To extend *BFP* to the point where it would offer protection to charities that receive donations from insolvents, it would have to be read as automatically exempting any bona fide, legal transaction from fraudulent conveyance attack (absent intent to defraud). There is some basis in *BFP* for the proposition that charitable contributions are per se not fraudulent. The *BFP* Court points to the ancient pedigree of foreclosure law and to the 400 years of peaceful coexistence between fraudulent conveyance and foreclosure doctrines.[174] Tithing is likewise an ancient institution, which has not been characterized as constructive fraud until relatively recently.[175] It could be argued in either context that departure from such a longstanding tradition requires clear legislative guidance. This line of reasoning certainly supports an exemption for tithes, but is not sufficient as a sole justification, given the plain language of the fraudulent conveyance statutes. This argument is also weakened by the trend in the law away from special protection

172. *See supra* part II.B.2.

173. *See supra* part II.C.2.

174. *BFP*, 114 S. Ct. at 1763-64.

175. It appears that *Missionary Baptist*, 24 B.R. 973, decided in 1982, is the earliest reported case dealing with an attack on a charitable contribution under fraudulent conveyance law involving an independent constructive fraud claim based on an absence of consideration. (It is noteworthy that the trustee in *Missionary Baptist* also alleged actual fraud. *Id.* at 974.)

for charities,[176] and by the proposition that the antiquity of a tradition does not necessarily prove its contemporary relevance.[177]

The *BFP* Court also emphasized the burden that voiding a foreclosure under Section 548 would place on the buyer.[178] This departure from the traditional emphasis on objectivity[179] might support a conclusion that it would be appropriate to exempt charitable donations from fraudulent conveyance attack because of the potential burden on the charity. Unquestionably, few non-profit organizations have cash reserves sufficient to disgorge large donations without a significant financial crisis. It is not clear, for example, how large the church in *Young* is; most community churches would be hard pressed to produce $14,450 in order to pay a judgment. An approach that considers the burden on the transferee would certainly protect non-profit charities from substantial liability.

A comparison to the *Chomakos* case[180] is illuminating here. The defendant casino in *Chomakos* is presumably in a better position to bear the loss of disgorging the allegedly fraudulent transfer than a charity. Nonetheless, the protection of the *BFP* rule is extended more easily to *Chomakos* than to a case like *Young*. What distinguishes *Chomakos* and *BFP* from the church cases is that when *Chomakos* and *BFP* considered the burden placed on the transferee, they focused on the hampering of business operations, not on the transferee's financial ability to disgorge the funds in question.[181] To extend *BFP* to the point where it would protect any transferee without the funds to conveniently repay the transfer in question would render fraudulent conveyance law hopelessly subjective, resulting in an inappropriate consideration of the transferee's overall financial status. The relevant issue in a fraudulent conveyance action is the transfer itself; the point of constructive fraud is to remove consideration of the subjective aspects of the exchange.[182] To extend *BFP* to the point where

176. *See infra* part III.A.2.

177. Burnham v. Superior Court, 495 U.S. 604, 629 (1990) (Brennan, J., concurring).

178. *BFP*, 114 S. Ct. at 1765.

179. *See supra* part II.A.

180. *See supra* notes 76-86 and accompanying text.

181. *See BFP*, 114 S. Ct. at 1765 (citing the title insurance industry's response to the *Durrett* decision); *Chomakos*, 170 B.R. at 596 (rejecting application of Section 548 due to potential "harm to society's interest in maintaining the integrity of legal and commercial transactions . . . .").

182. *See supra* part II.A.

charitable contributions are per se made for reasonably equivalent value would represent a substantial step backwards in fraudulent conveyance doctrine.

III. Should Charitable Contributions by Insolvent Debtors Be Fraudulent Conveyances?

The confines of traditional fraudulent conveyance doctrine leave little room for the judicial protection of charities. If the recipients of charitable contributions hope to be shielded from fraudulent transfer actions, their relief must come from the legislature. It has in fact been proposed that the Bankruptcy Code be amended to exempt tithes from fraudulent conveyance attack.[183] Of course, such a congressionally-created federal immunity would apply only to actions brought by bankruptcy trustees; tithes would still be susceptible to state law attacks by creditors in non-bankruptcy situations, unless each state also amended its fraudulent transfer statute.[184]

The larger issues involve whether such an exemption is appropriate, what its scope should be, and what other remedies might otherwise be suitable. A number of policy questions are implicated: Should all charities be protected? Should, as has been suggested, an exemption be created exclusively for religious contributions? Is it appropriate for debtors to make charitable contributions when insolvent?

A. Should There Be an Exception for Charities?

As discussed above,[185] an obligation to disgorge contributions that prove to be constructively fraudulent would be quite burdensome to many non-profit organizations. While larger charities, like the committee in *GOP Dinner* or private colleges, may have sufficient cash reserves to respond to such challenges, small non-profits like local churches or volunteer fire companies tend to commit what funds they have to their financial needs. A bankruptcy trustee is unlikely to identify and pursue fraudulent conveyances immediately upon appointment. By the time a charity is notified that it has received a voidable transfer, two years may have passed

183. President Clinton has indicated that he feels that a legislative response would be appropriate if the *Young* decision is affirmed. Thomas, *supra* note 2.

184. *See supra* note 53-56 and accompanying text.

185. *See supra* text accompanying notes 178-79.

since it received the funds.[186] By that time, the charity will doubtless have committed, and probably spent, the amount of the donations.

1. Analogy to Preferences. — On the other hand, a comparison could be made to preference actions brought under Section 547 of the Bankruptcy Code. The preference statute voids payments made by insolvent debtors to their creditors in the ninety days prior to the filing of the bankruptcy petition, if the payments result in an improvement of the recipient's position relative to the other creditors.[187] The preference and constructive fraud provisions of the Code serve similar functions. Both act to ensure that the creditors as a class are not forced to suffer when an individual transferee enjoys a windfall. Each strikes to the heart of bankruptcy policy; when a debtor is unable to repay her debts in full, the only equitable resolution is to ensure that the burden of that

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186. For example, the debtor in *Missionary Baptist* filed its chapter eleven petition in October of 1980. *Missionary Baptist*, 24 B.R. at 975. The bankruptcy court decision finding that the debtor's transfers to the defendant charity were not fraudulent was issued in November of 1982.

A bankruptcy trustee may bring an action under the avoidance powers for two years after the filing of the bankruptcy. 11 U.S.C. § 546(a) (1994).

187. *Id.* § 547. The preference statute provides:

> [T]he trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Id. § 547(b). Transfers are not avoidable as preferences if they are: (1) contemporaneous exchanges for new value; (2) made in the ordinary course of business; (3) merely the perfection of a prior secured debt; (4) followed by an advance of new value by creditor to debtor; (5) the perfection of a secured interest in inventory or receivables; (6) the fixing of a nonavoidable statutory lien; or (7) under $600 and made by an individual debtor for a consumer debt. *Id.* § 547(c).

inability is borne equally by all parties.[188] Just as no one creditor may benefit from a relatively larger payback on its claims than the others (a preference), no transferee should benefit from a gift from the debtor when the creditors are being asked to accept little or no payment on their claims.

Both statutes place a similar burden on the recipient of a voided transfer. While it seems onerous and unfair to the transferee to have to give back the funds when it has done nothing wrong, it would be even more unfair to other creditors to ask them to forgo their claims while the transferee keeps its windfall. If anything, the voiding of constructively fraudulent transfers is easier to justify than preferences, particularly when the fraudulent conveyance is gratuitous. Unlike the creditors, the transferee has expended no labor or risk in exchange[189] for the money it got from the debtor.[190] Disgorging the fraudulent conveyance may be burdensome for the transferee, but it was, after all, a gift. The indignation of a donee at having to return a gift wrongfully given can be no greater than the indignation of a preference creditor at having to return what little payment it has been able to eke out of the debtor.[191]

2. Analogy to Charitable Immunity. — A further analogy to the history of charities' immunity from tort liability might also be considered. Prior to the twentieth century, charities were generally immune from liability for the torts of their employees and agents.[192] This immunity has been largely abrogated by the

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188. *See id.* §§ 726(b), 1123(a)(4), 1322(a)(3) (providing for equal distribution to similarly classified creditors).

189. "Exchange" being used here in a strict "exchange for new value" sense.

190. Professor Carlson argues that this outcome is appropriate from an economic point of view, since donees, unlike creditors, have not worked for their stake in the debtor's estate, and therefore have not contributed to the public wealth. Carlson, *supra* note 119, at 673-74. This thesis is more convincing when applied to donees who receive personal gifts than to donees who receive charitable contributions. While non-profits may not contribute to the public wealth from an economist's point of view, they quite often contribute to the public welfare in very significant ways.

191. Anyone who has received a telephone call from a creditor who has just been served with a preference complaint can attest to this indignation. The creditor is already unhappy with the fact that the debtor is about to discharge the remaining claim through bankruptcy. A demand that the creditor give up what payment it has gotten immediately prior to the bankruptcy is viewed as adding insult to injury.

192. *See* Annotation, *Immunity of Nongovernmental Charity from Liability for Damages in Tort*, 25 A.L.R.2d 29 (1952).

courts of almost every state.[193] While many of the seminal cases rejecting charitable immunity involve the liability of charitable hospitals,[194] a number of modern cases hold that a charitable organization of any sort must be treated like any other institution.[195] As a number of courts have reasoned, an injury caused by tortuous conduct is no less painful or disabling to the injured party when inflicted by a charitable institution.[196] The injured party should not be compelled to make a de facto contribution to the charity by absorbing the cost of the injury when a different defendant would be liable.[197] Reasoning that charities, like others, must place justice before generosity,[198] a number of courts have found it anomalous that an organization that exists to dispense charity should be absolved of any obligation to those it injures.[199]

The abandonment of charitable immunity for torts suggests that the creation of a new immunity for charities as to fraudulent conveyances would be inappropriate. From the point of view of creditors, it makes no difference who was the beneficiary of the debtor's largesse. While a donation to charity may offend the conscience less than a gift to a family member, both cause an equal diminution of the debtor's estate. Either way, the creditors' potential recovery is reduced. When an insolvent makes charitable donations, she does so at her creditor's expense. It makes no more sense to compel creditors to underwrite such generosity than it does to make those injured by tortious conduct absorb the cost of the charity's operation.[200]

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193. *See* Janet Fairchild, Annotation, *Tort Immunity of Nongovernmental Charities—Modern Status*, 25 A.L.R.4th 517 (1983).

194. *E.g.*, Georgetown College v. Hughes, 130 F.2d 810 (D.C. Cir. 1942); Mulliner v. Evangelischer Diakonniessenverein, 175 N.W. 699 (Minn. 1920); Nicholson v. Good Samaritan Hosp., 199 So. 344 (Fla. 1940).

195. *E.g.*, Bell v. Presbytery of Boise, 421 P.2d 745, 747 (Idaho 1966); Albritton v. Neighborhood Ctrs. Assoc. for Child Dev., 466 N.E.2d 867, 870 (Ohio 1984); *see also* Fairchild, *supra* note 193.

196. *E.g.*, *Bell*, 421 P.2d at 747; *Albritton*, 466 N.E.2d at 870.

197. Foster v. Roman Catholic Diocese, 70 A.2d 230, 235 (Vt. 1950); Friend v. Cove Methodist Church, Inc., 396 P.2d 546, 549 (Wash. 1964); *Albritton*, 466 N.E.2d at 870-71.

198. *See supra* note 11.

199. Geiger v. Simpson Methodist-Episcopal Church, 219 N.W. 463, 465 (Minn. 1928); *Albritton*, 466 N.E.2d at 870; *see also Friend*, 396 P.2d at 549.

200. This compelled donation argument is supported by Professor Tabb's thesis that debtors have a fiduciary obligation as to their creditors. *See infra* note 206 and accompanying text. Under such reasoning, an insolvent who makes charitable donations is in fact giving away her creditors' money, which she is holding in trust.

B. Should Insolvents Be Making Charitable Contributions?

Regardless of our response to the dilemma faced by charities receiving fraudulent conveyances, a larger policy question remains: Is it appropriate for insolvent debtors to be making contributions to charities? The answer to this question underlies the debate over how to respond to such contributions. While modern fraudulent conveyance doctrine strives for objectivity,[201] and has moved away from the penal nature of the sixteenth-century Statute of Elizabeth,[202] voiding transfers is still in some way rooted in the notion that the transfer never should have occurred. Even when intent to defraud is unnecessary for a conveyance to be deemed fraudulent, some element of moral or social wrong must be present for us to be comfortable with the idea that the transfer should be undone.[203]

1. Justice Before Generosity. — The underlying principle of fraudulent conveyance law is that an insolvent must be just before she is generous.[204] A constructively fraudulent transfer represents generosity whether it is purely gratuitous or made for value that is not reasonably equivalent to the size of the transfer. In either case, the conveyance is a gift to the extent that the value given exceeds the consideration received in return. There is nothing wrong with giving gifts, just as there is nothing wrong with making charitable donations. Indeed, charitable donations fund many valuable institutions, ranging from churches to museums to medical research.[205] The difficulty arises when funding charities comes into conflict with a debtor's legal obligations to her creditors. Incurring debt involves making an affirmative promise to repay. When a debtor's finances are so reduced that she cannot meet all of her obligations, she should honor her legal duties before her moral ones. To paraphrase the words of many debtors (when asked in the course of preparing bankruptcy petitions how much money they

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201. *See supra* part II.A.

202. *Id.*

203. *See supra* note 167 and accompanying text (the *Young* court's suggestion that the results in *Missionary Baptist* and *Moses* are the product of courts misapplying the law in order to reach the "right" result).

204. *See supra* note 11.

205. The favorable tax treatment given to charitable donations and gifts affirms our society's belief that such transfers are in the public interest and should be encouraged. *See* I.R.C. §§ 102, 170 (West 1994).

give each month to charitable causes): an insolvent debtor *is* a charitable cause.

Professor Charles J. Tabb argues than an insolvent debtor holds her unencumbered assets in trust for the benefit of her creditors.[206] In this sense, creditors have an equitable interest in the debtor's property. The inappropriate or inequitable diminution of that property represents a compromise of the creditors' interests. The debtor-as-trustee certainly will not be held to such a high duty that she cannot expend money for her daily sustenance, but it seems fair to demand that she curtail her discretionary spending.

2. Analogy to Sections 1325 and 707(b) of the Bankruptcy Code. — The difficult question then becomes whether charitable contributions may be included in those expenses necessary for the debtor to sustain herself. Courts and commentators have discussed this issue at some length in the context of the inclusion of tithing in a debtor's chapter 7 or chapter 13 budget.[207] A debtor attempting to restructure her affairs under chapter 13 of the Code must commit to her plan of reorganization all income not reasonably necessary for her maintenance and support.[208] A similar requirement has been inferred for chapter 7 debtors under Section 707(b)'s provision for dismissal for substantial abuse.[209] The test for the appropriateness of expenses in the debtor's budget is the same under both sections: Are the expenses listed reasonably necessary for the maintenance and support of the debtor and her dependents?[210]

Courts are divided over the treatment of tithing in debtors' budgets. While a few have held that religious contributions may

206. Charles J. Tabb, *Rethinking Preferences*, 43 S.C. L. REV. 981, 991-92 (1992).

207. *E.g.*, James Rodenberg, Comment, *Reasonably Necessary Expenses or Life of Riley? The Disposable Income Test and a Chapter 13 Debtor's Lifestyle*, 56 MO. L. REV. 617 (1991); Leonard J. Long, *Religious Exercise as Credit Risk*, 10 BANKR. DEV. J. 119 (1994); Bruce Edward Kosub & Susan K. Thompson, *The Religious Debtor's Conviction to Tithe as the Price of a Chapter 13 Discharge*, 66 TEX. L. REV. 873 (1988). A number of articles also discuss the constitutional implications of this issue. *See infra* note 224.

208. 11 U.S.C. § 1325(b)(1)(B), (b)(2) (1994).

209. *Id.* § 707(b). Courts have interpreted substantial abuse to mean that the debtor has sufficient income to fund a chapter 13 plan. Fonder v. United States, 974 F.2d 996 (8th Cir. 1992); *In re* Krohn, 886 F.2d 123 (6th Cir. 1989); *In re* Kelly, 841 F.2d 908 (9th Cir. 1988). *But see In re* Green, 934 F.2d 568 (4th Cir. 1991) (applying a totality of the circumstances approach).

210. 11 U.S.C. § 1325(b)(2).

constitute reasonably necessary expenses,[211] a number of decisions at least partially limit a debtor's freedom to tithe.[212] It is clear that the bankruptcy court, in considering a debtor's budget, should not expect the debtor to live on bread and water for the duration of her plan, but the budget should indicate that the debtor is not living extravagantly.[213] If the debtor asks her creditors to sacrifice by accepting a loss on their claims against her, she should be willing to accept a concomitant sacrifice in her lifestyle; in determining what constitutes a reasonably necessary expense, "'reasonable' means 'adequate' but not 'first-class.'"[214] While basic expenses like rent and food are clearly essential, expenses that go to the debtor's emotional and spiritual health are more debatable. In this context, tithing might arguably fall into a category of unnecessary (or limitable) expenses such as long-distance telephone calls or recreational activities.[215]

Of course, attending church is not recreation for a religious debtor. The crucial distinction is rather between discretionary and non-discretionary expenses. The debtor has no choice but to purchase food sufficient to feed herself and her family; the debtor can choose to give less to charity.[216]

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211. *E.g.*, *In re* Navarro, 83 B.R. 348 (Bankr. E.D. Pa. 1988); *In re* Bien, 95 B.R. 281, 283 (Bankr. D. Conn. 1989); *In re* Green, 73 B.R. 893 (Bankr. W.D. Mich. 1987).

212. *E.g.*, *In re* Cavanaugh, 175 B.R. 369, 374-75 (Bankr. D. Idaho 1994); *In re* Curry, 77 B.R. 969 (Bankr. S.D. Fla. 1987); *In re* Lee, 162 B.R. 31 (Bankr. N.D. Ga. 1993); *In re* Sturgeon, 51 B.R. 82 (Bankr. S.D. Ind. 1985); *In re* Breckenridge, 12 B.R. 159 (Bankr. S.D. Ohio 1980); *In re* Reynolds, 83 B.R. 684 (Bankr. W.D. Mo. 1988) (limiting permissible contributions to 3%); *In re* Faulkner, 165 B.R. 644 (Bankr. W.D. Mo. 1994) (following *Reynolds* 3% rule); *see also In re* Lynn (Lynn v. Diversified Collection Serv.), 168 B.R. 693 (Bankr. D. Ariz. 1994) (10% tithe not an appropriate expense in considering dischargeability of student loan).

213. "Chapter 13 debtors are not required to live at a poverty level." *In re* Anderson, 143 B.R. 719, 721 (Bankr. D. Neb. 1992) (limiting to $150 debtors' monthly discretionary expenses); *see also In re* Gaskins, 85 B.R. 846 (Bankr. C.D. Cal. 1988) (new car); *In re* Bell, 56 B.R. 637 (Bankr. E.D. Mich. 1986), *vacated on other grounds*, 65 B.R. 575 (luxury car, eating in restaurants); *In re* Sutliff, 79 B.R. 151 (Bankr. N.D.N.Y. 1987) (excessive recreation expenses); *In re* Hedges, 68 B.R. 18 (Bankr. E.D. Va. 1986) (boat).

214. *In re* Easley (Nelson v. Easley), 72 B.R. 948, 949 (Bankr. M.D. Tenn. 1987); *see also In re* Kitson, 65 B.R. 615, 622 (Bankr. E.D.N.C. 1986) ("A chapter 13 debtor who proposes to pay his creditors 38 cents on the dollar cannot expect to 'go first class' when 'coach' is available.").

215. *See Cavanaugh*, 175 B.R. at 374-75; *Anderson*, 143 B.R. at 721.

216. *Cavanaugh*, 175 B.R. at 374-75 (treating tithing as part of a class of discretionary expenses, along with contributions to a 401K retirement plan, "modest dinners out," and newspapers); *see also In re* Lynn (Lynn v. Diversified Collection Serv.), 168 B.R. 693, 696 (Bankr. D. Ariz. 1994) (debtor seeking to have student loans discharged due to hardship

A few courts have resolved this issue through compromise, by permitting as reasonable tithes at three percent of debtor's income.[217] While it may be difficult in theory to apply such a rule to alleged fraudulent conveyances,[218] a similar solution is doubtless already in force on a practical level; small (i.e. "reasonable") pre-bankruptcy charitable contributions are not attacked as fraudulent simply because not enough money is at stake to justify the legal expense involved. The parallel ceases to work, of course, when the debtor's income is so high that three percent represents a substantial dollar figure. In such circumstances, a contribution that would satisfy the three percent rule under Section 1325 might nonetheless be large enough to merit attack as fraudulent.[219]

A three percent rule may be an appealing solution to the fraudulent charitable donation problem. It is fair to ask the debtor to make sacrifices when possible to maximize the funds available to her creditors. An outright ban on religious or other charitable giving would be an excessive imposition on the debtor's life. After all, if debtors may include reasonable recreation expenses in their budgets,[220] they should also be allowed some other discretionary spending. Nonetheless, some restriction on amount does seem just.[221] The difficulty with the three percent rule as a formal solution arises due to its incompatibility with the language of Section 548. Unlike the preference statute, Section 548 contains no

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under 11 U.S.C. § 523(a)(8)(B) "testified that at times, she went without food because of her commitment to tithe."); *supra* note 137 (debtor in *Missionary Baptist* wrote bad payroll checks while continuing to make substantial charitable donations).

217. *E.g.*, *In re* Reynolds, 83 B.R. 684 (Bankr. W.D. Mo. 1988); *In re* Faulkner, 165 B.R. 644 (Bankr. W.D. Mo. 1994); *see also In re* Anderson, 143 B.R. 719 (Bankr. D. Neb. 1992) (limiting to $150 debtors' monthly discretionary spending, including church contributions); *In re* McDaniel, 126 B.R. 782 (Bankr. D. Minn. 1991) (permitting reduced tithing); *In re* Navarro, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988) (permitting some level of religious giving).

218. There is no basis for finding that a conveyance is not fraudulent merely because it is small.

219. Of course, since the debtor must be insolvent for the transfer to be constructively fraudulent, 11 U.S.C. § 548(b)(i), and since insolvency is generally determined under the Code by a balance sheet test, *id.* § 101(32), the transfers will likely represent less than three percent of outstanding claims. After deduction of the trustee's commission and legal fees, this might not yield a sufficient dividend to justify pursuit.

220. *E.g.*, *In re* Tefertiller, 104 B.R. 513, 515 (Bankr. N.D. Ga. 1989) (under § 707(b)); *In re* Schyma, 68 B.R. 52, 64 (Bankr. D. Minn. 1985) (under § 1325); *In re* Struggs, 71 B.R. 96, 98 (Bankr. E.D. Mich. 1987) (under § 707(b)); *see also* Rodenberg, *supra* note 207, at 648-53.

221. For an overview of the constitutional issues implicated, see *infra* part III.C.

exemption for small transactions,[222] nor does it authorize judicial acceptance of "reasonably necessary" expenditures.[223] The introduction of such an exception for modest contributions must come from Congress.

C. *The Special Problem of Religious Charities*

When the charitable contribution under attack as fraudulent is religious in nature, significant constitutional issues are implicated. A detailed discussion of such issues is beyond the scope of this Comment, but a brief overview is in order.[224] The First Amendment provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ."[225] Treatment of tithes as fraudulent conveyances has been challenged under both the establishment and free exercise clauses.[226]

1. The First Amendment's Free Exercise Clause. — The present state of the law on free exercise is complex. In 1990, the Supreme Court limited the application of strict scrutiny analysis of laws that infringe upon religion in *Employment Division v. Smith*.[227] In response to the *Smith* decision, Congress in 1993 passed the Religious Freedom Restoration Act,[228] or RFRA, which expressly restores the protection of strict scrutiny to religious activity burdened by government actions.[229] The relationship between RFRA and the Supreme Court's First Amendment

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222. 11 U.S.C. § 547(c)(8) exempts from preference avoidance transfers by consumer debtors under $600.

223. *See supra* part III.B.2.

224. For a discussion of the constitutional issues surrounding the inclusion of tithes in a debtor's budget, see Long, *supra* note 57; Donald R. Price & Mark C. Rahdert, *Distributing the First Fruits: Statutory and Constitutional Implications of Tithing in Bankruptcy*, 26 U.C. DAVIS L. REV. 853 (1993); Carol Koenig, Comment, *To Tithe or Not To Tithe: The Constitutionality of Tithing in a Chapter 13 Bankruptcy Budget*, 32 SANTA CLARA L. REV. 1231 (1992).

225. U.S. CONST. amend. I.

226. *E.g.*, *In re* Newman (Morris v. Midway S. Baptist Church), 183 B.R. 239 (Bankr. D. Kan. 1995); *In re* Young (Christians v. Crystal Evangelical Free Church), 152 B.R. 939 (D. Minn. 1993); *In re* Moses (Ellenberg v. Chapel Hill Harvester Church, Inc.), 59 B.R. 815 (Bankr. N.D. Ga. 1986); *see also In re* Green, 73 B.R. 893 (Bankr. W.D. Mich. 1987), *aff'd*, 103 B.R. 852 (W.D. Mich. 1988) (under § 1325); *In re* Lee, 162 B.R. 31 (Bankr. N.D. Ga. 1993) (under § 707(b)).

227. 494 U.S. 872 (1990).

228. Pub. L. No. 103-141, 107 Stat. 1488 (1993) (codified at 42 U.S.C. § 2000bb).

229. 42 U.S.C. § 2000bb (1994).

jurisprudence is unclear. Under *Marbury v. Madison*,[230] the Court is still the sole arbiter of the meaning of the Constitution; RFRA appears to give an individual who feels that her religious freedom is being imposed upon a separate, statutory cause of action.[231]

Under *Smith*, a "valid and neutral law of general applicability" does not violate the Free Exercise Clause.[232] An individual may not claim an exemption from a law that is valid as to the rest of society, merely because it happens to burden her religious exercise. The defendants in *Smith*, for example, were not free from the operation of a state law banning the use of peyote on the grounds that the use was mandated by their religion.[233]

A direct application of *Smith* suggests that treatment of tithing by insolvents as constructively fraudulent does not violate the Free Exercise Clause. The Bankruptcy Code is neutral towards religious practice in general; fraudulent conveyance doctrine does not single out religious contributions, but instead treats all voluntary conveyances as voidable. Just such a result was reached by the *Young* court, which ruled that Section 548's effect on religion, like that of the ban on peyote in *Smith*, was incidental, and therefore not an imposition on free exercise.[234] Even when the debtor's religion mandates tithing (as does, for example, the Mormon faith), the incidental effect on the debtor of fraudulent conveyance treatment is not a violation of First Amendment rights.

RFRA was drafted in response to the *Smith* decision.[235] RFRA applies a strict scrutiny test to any law that burdens religion, regardless of its neutrality.[236] A law that burdens religion is impermissible unless the government can demonstrate that: (1) the law furthers a compelling governmental interest; and (2) the law is

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230. 5 U.S. 137 (1803).

231. *See* RODNEY A. SMOLLA, FEDERAL CIVIL RIGHTS ACTS § 5.03[3][a] (3d ed. 1995); *see also Newman*, 183 B.R. at 249-52 (applying the Free Exercise clause and RFRA separately). It has been suggested that, under *Marbury*, RFRA is unconstitutional. Kimberly A. Taylor, *Recent Decision: Constitutional Law*, 32 DUQ. L. REV. 915, 937-38 (1994). *But see* SMOLLA, *supra* at § 5.03[3][a].

232. *Smith*, 494 U.S. at 879 (quoting United States v. Lee, 455 U.S. 252, 263 n.3 (1982) (Stevens, J., concurring in judgment)).

233. *Id.*

234. *Young*, 152 B.R. at 953-54; *see also Newman*, 183 B.R. at 250; *Cavanaugh*, 175 B.R. at 374.

235. 42 U.S.C. § 200bb(a).

236. *Id.* § 200bb-1.

the least restrictive means of furthering that interest.[237] Courts have found in the past that the administration of bankrupts' estates is a compelling government interest.[238] If establishment of bankruptcy policy is, in broad terms, a compelling governmental interest, then the equitable distribution of assets, including drawing voluntary conveyances into the estate for the benefit of creditors, must likewise pass the RFRA test.[239] Alternative means of preventing diminution of a debtor's estate, such as a prohibition on charitable giving, would be both more restrictive and more difficult to administrate.

Proponents of the application of RFRA will doubtless argue that there are other, less restrictive ways of administering the estates of bankrupts.[240] For example, Congress could broaden the denial of discharge provisions of Section 737 to discourage pre-bankruptcy transfers.[241] Such a remedy would avoid the burden upon religious organizations that a Section 548 action represents; it would not, however, avoid the burden placed upon the debtor's religious practices. Alternatively, Congress could adopt an exception for modest transfers, similar to the three percent rule followed by some courts with regard to chapter 13 debtors'

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237. *Id.* § 200bb-1(b). RFRA expressly restores pre-*Smith* jurisprudence, providing that:

> Government may substantially burden a person's exercise of religion only if it demonstrates that application of burden to that person—
>
> (1) is in furtherance of an compelling governmental interest; and
>
> (2) is the least restrictive means of furthering that compelling governmental interest.

Id.

238. *E.g.*, *Newman*, 183 B.R. at 251 (decided under RFRA; holding that Section 548 serves a compelling government interest); *In re* Faulkner, 165 B.R. 644 648 (Bankr. W.D. Mo. 1994) (decided under RFRA); *Young*, 152 B.R. at 954; *In re* Navarro, 83 B.R. 348, 353 (Bankr. E.D. Pa. 1988).

Senator Orin Hatch, one of the co-sponsors of RFRA, has indicated that he feels that *Young* represents just the sort of situation RFRA was designed to address. 140 CONG. REC. S5014-01, S5015 (1994). The Department of Justice had originally filed an amicus brief with the Eighth Circuit in the *Young* appeal, supporting the trustee on the bankruptcy law issues. The White House subsequently ordered the brief withdrawn, basing its reversal on the proposed application of RFRA to the case. *Religion: Administration Withdraws Brief in Case Pitting Trustee Against Debtor's Church*, BNA BANKRUPTCY LAW DAILY, Sept. 20, 1994.

239. *See Newman*, 183 B.R. at 251-52 (holding that the voiding of tithes as fraudulent conveyances does not violate RFRA.).

240. *See* Michael M. Duclos, *A Debtor's Right to Tithe in Bankruptcy Under the Religious Freedom Restoration Act*, 11 BANKR. DEV. J. 665 (1995).

241. *See infra* part III.D.

budgets.[242] While a three percent rule represents a practical compromise between the interests at stake, it does little to avoid the burdens of cases like *Young*. As discussed above,[243] few trustees will bring a fraudulent conveyance action when the transfer in question is very small relative to the outstanding claims; such a de minimis rule offers no solace to churches that have received and spent large contributions.

2. The First Amendment's Establishment Clause. — The Supreme Court recently described the relationship between government and religion as one that must be inherently neutral: "'A proper respect for both the Free Exercise and the Free Establishment Clauses compels the State to pursue a course of 'neutrality' toward religion,' favoring neither one religion over others nor religious adherents collectively over nonadherents."[244] It is this emphasis on neutrality that makes the creation of an exemption for tithing from fraudulent conveyance attack problematic. An exclusion that protects churches but not secular charities would be an impermissible preference of religion. By the same token, an exclusion that treats differently tithes by members of churches that mandate contribution (like Mormons) from tithes by those for whom giving is optional, would be preferential treatment of one belief over another.[245]

The Establishment Clause may, on the other hand, be raised as a defense by churches against fraudulent conveyance actions. Prior to 1994, the Court followed a three-part test to determine whether governmental action violates the establishment clause: to pass constitutional muster, a statute must (1) have a secular purpose, (2) have a primary effect that neither advances nor inhibits religion, and (3) not foster excessive government entanglement with religion.[246] It is presently unclear whether this approach survives, or whether it has been replaced by the totality-of-the-circumstances analysis employed by the Court in its *Kiryas Joel*

242. *See supra* part III.B.2.

243. *See supra* text accompanying note 219.

244. Board of Educ. of Kiryas Joel v. Grumet, 114 S.Ct. 2481, 2487 (1994) (quoting Committee for Public Educ. & Religious Liberty v. Nyquist, 413 U.S. 756, 792-93 (1973)) (citations omitted).

245. *Id.* (creation of school district for benefit of Hasidic Jewish sect violates Establishment Clause).

246. Lemon v. Kurtzman, 403 U.S. 602, 613 (1971).

decision.[247] If the three-prong analysis endures, there appears to be little basis under it for the protection of tithes. The Bankruptcy Code certainly has a secular purpose, and the primary effect of voiding fraudulent conveyances is neutral towards religion.[248] There is authority for the proposition that the government may impose financial burdens on religious organizations without excessive entanglement.[249] Likewise under a *Kiryas Joel* totality analysis, favoring religious over secular giving by creating an exception would represent a greater violation of the Establishment Clause than does the treatment of charitable contributions as constructively fraudulent.

3. Exemptions. — A related insight into the Code's treatment of religion may be found in the exemptions it grants to a debtor. It has been suggested that one of the reasons that the law has traditionally exempted certain property of a debtor from attachment by her creditors is the protection of the debtor's dignity, culture, and religious identity.[250] A number of states, therefore, exempt such property as family pictures, wedding rings, books, seats occupied in places of worship, and Bibles.[251] While the Bankruptcy Code exempts jewelry[252] and household goods,[253] it provides no separate exemption for religious items such as Bibles. It may be than no larger meaning should be inferred from this; Congress may have assumed that religious items such as Bibles would be exempted along with household goods.[254] Such a specific exemption may have been avoided, in fact, out of a concern that a blanket protection of religious items would violate the

247. *See Kiryas Joel*, 114 S. Ct. at 2498-2500 (O'Connor, concurring); Patricia A. Brannan & Daniel B. Kohrman, *Commentary: The 1993-94 Term of the United States Supreme Court and its Impact on Public Schools*, 93 ED. L. REP. 1, 8 (1994).

248. *See Young*, 152 B.R. at 955; *Cavanaugh*, 175 B.R. at 374.

249. *E.g.*, Jimmy Swaggart Ministries v. Board of Equalization, 493 U.S. 378, 396 (1990) (sales & use tax); South Ridge Baptist Church v. Industrial Comm'n, 911 F.2d 1203 (6th Cir. 1990), *cert. denied*, 498 U.S. 1047 (1991); *see also Young*, 152 B.R. at 955 (suggesting that trying set a cash value on the spiritual benefits of tithing would be excessive entanglement).

250. Resnick, *supra* note 103, at 623-24.

251. *Id.*

252. 11 U.S.C. § 522(d)(4) (1994).

253. *Id.* § 522(d)(3).

254. Section 522(d)(3)'s exemption of $8,000 worth of household goods per debtor, at distressed-sale values, is ample to protect the personal property of most individual debtors.

Establishment Clause.[255] The absence of such an exemption, however, may represent a decision by Congress to treat religion in a neutral manner under the Code. The message implied is that the debtor's religious beliefs, to the extent that they are manifested in tangible and economic ways, must bear the burden of insolvency and bankruptcy along with the secular aspects of the debtor's life.

D. An Alternative Solution: Denial of Discharge for Gross Fiscal Negligence

Since voiding an irresponsible transfer may, in some cases, be inequitable as to the transferee, an alternative remedy might focus on the debtor. The Code provides for denial of discharge when the debtor has made transfers with the intent to hinder, delay, or defraud creditors.[256] One solution to the problem of irresponsible transfers that are made in good faith, and that are not constructively fraudulent (such as the hypothetical trip to Paris), might be an expansion of this dischargeability provision. Discharge could be denied when the debtor's actions rise to the level of gross negligence. If we accept Professor Tabb's proposition that the debtor has a fiduciary duty to her creditors,[257] then irresponsible spending would represent a breach of this duty. The Code might be amended to deny discharge when the debtor was negligent as to her responsibility to her creditors.

While such a remedy would not increase the funds available to creditors from the bankruptcy estate, it would allow creditors to preserve their claims against the debtor. In theory, a debtor comes out of bankruptcy with no assets left for creditors, but in actuality, most creditors would regard a preservation of their claims as preferable to discharge. Many state exemption statutes are less generous than the bankruptcy exemptions, so it is possible for a debtor to emerge from bankruptcy with assets that potentially would be subject to attachment or levy under state law. Further, if the debtor's circumstances subsequently improve, the creditors can pursue their claims via attachment of wages or levy of newly obtained property.

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255. The constitutionality of state-law exemptions for Bibles does not appear to have been tested.

256. 11 U.S.C. § 737(a)(2).

257. *See infra* note 206 and accompanying text.

Although this remedy would offer some solace to creditors, it is unlikely to have very much deterrent effect. Most debtors are not aware of the intricacies of the Bankruptcy Code in the months prior to filing; while a denial of discharge for negligence might prevent irresponsible spending by those debtors who seek advice of counsel, those who are not so well informed may continue to spend unwisely, and face (with surprise) the burdensome consequences.

Addition of negligent spending to the denial of discharge provision also raises the question of what spending would be considered negligent. We may be able to agree that the luxury vacation in Paris deserves censure, but are we going to examinine the merits of each purchase, of each tank of gas? How will we treat charitable contributions? We can argue that voiding a constructively fraudulent conveyance is not punishment, but is merely equitable reallocation of assets; a denial of discharge provision is unquestionably punitive. Are we prepared to say that the failure to place justice before generosity is so irresponsible as to merit punishment?

IV. Conclusion

A principle of shared sacrifice is essential to our bankruptcy policy. Creditors must sacrifice by accepting reduced payment, or no payment, on their claims. Debtors must sacrifice by devoting non-exempt property and excess income to the repayment of their obligations. These sacrifices must be shared fairly. Thus, preferential treatment of certain creditors is prohibited,[258] and general unsecured creditors must share the assets of the estate in equal proportion.[259]

As a matter of prudence, an insolvent debtor should cut back on discretionary spending, such as entertainment and charitable giving, in order to devote her limited resources to paying back her debts. Once she asks the courts for relief under the Bankruptcy Code, such fiscal restraint must become a matter of policy. We can not fairly ask creditors to sacrifice their financial interests when the debtor has no obligation to make sacrifices in her lifestyle. It defies logic to suggest that a law that relieves debtors of their legal obligations should not also have some impact on their moral obligations.

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258. 11 U.S.C. § 547.

259. *Id.* §§ 726(a)(2), 1123(a)(4), 1322(a)(3).

This is not to suggest that charitable giving is against public policy, or even against public policy for debtors. The charitable giving of insolvents and bankrupts, however, ought to be limited to giving at a reasonable level. A debtor's spiritual existence may be enhanced by any number of discretionary expenditures: tithing, giving money to the homeless, going on vacation. Bankruptcy is not intended to place a debtor in a state of indentured servitude, on a bread-and-water diet, but it does inherently ask the debtor to make certain sacrifices. Generosity is certainly laudable, but justice must come first.

Robert J. Bein